DOCUMENT RESUME

ED 143 607 SO 010 287

TITLE	Research Papers Sponsored by the Commission on Private Philanthropy and Public Needs. Volume V: Regulation.
INSTITUTION	Department of the Treasury, Washington, D.C.
PUB DATE	77
NOTE	575p.; For related documents, see SO 010 282-286; Not available in hard copy from EDRS due to small type size of parts of the original document
EDRS PRICE	MF-$1.00 Plus Postage. HC Not Available from EDRS.
DESCRIPTORS	Accountability; Bookkeeping; *Federal Legislation; Financial Support; Foreign Countries; Foundation Programs; *Government Role; Grants; *Private Financial Support; *Program Validation; *State Legislation; Tax Support; *Voluntary Agencies
IDENTIFIERS	*Canada; *England; France; Italy; Japan; Sweden; West Germany

ABSTRACT

The report describes regulation of philanthropic organizations by federal, state, and self-regulatory groups within the organizations. It is the final volume in a five volume series examining the relationship between nonprofit institutions and their donors. Topics discussed in the first part of this volume are regulation of the philanthropic sector, accountability with respect to financial reporting, solicitation and fund raising, and lobbying activities. Detailed procedures and pending legislation are reviewed concerning federal and state regulations. Section two examines tax incentives, matching grant programs, and regulation of charities in foreign countries. Special emphasis is on Canada and Great Britain. Other countries reviewed are Australia, France, West Germany, Italy, Japan, and Sweden. (Author/AV)

****
* Documents acquired by ERIC include many informal unpublished *
* materials not available from other sources. ERIC makes every effort *
* to obtain the best copy available. Nevertheless, items of marginal *
* reproducibility are often encountered and this affects the quality *
* of the microfiche and hardcopy reproductions ERIC makes available *
* via the ERIC Document Reproduction Service (EDRS). EDRS is not *
* responsible for the quality of the original document. Reproductions *
* supplied by EDRS are the best that can be made from the original. *
****

ED143607

U S DEPARTMENT OF HEALTH,
EDUCATION & WELFARE
NATIONAL INSTITUTE OF
EDUCATION

THIS DOCUMENT HAS BEEN REPRODUCED EXACTLY AS RECEIVED FROM THE PERSON OR ORGANIZATION ORIGINATING IT. POINTS OF VIEW OR OPINIONS STATED DO NOT NECESSARILY REPRESENT OFFICIAL NATIONAL INSTITUTE OF EDUCATION POSITION OR POLICY

OCT 5 1977

Research Papers

Sponsored By

The Commission on Private Philanthropy
and Public Needs

Volume V

Regulation

Department of the Treasury
1977

SO 010 287

COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS

John H. Filer, *Chairman*

Leonard L. Silverstein, *Executive Director*

William H. Bowen
Lester Crown
C. Douglas Dillon
Edwin D. Etherington
Bayard Ewing
Frances Tarlton Farenthold
Max M. Fisher
Raymond J. Gallagher
Earl G. Graves
Paul R. Haas
Walter A. Haas, Jr.
Philip M. Klutznick
Ralph Lazarus
Herbert E. Longenecker
Elizabeth J. McCormack
Walter J. McNerney
William H. Morton
John M. Musser
Jon O. Newman
Graciela Olivarez
Alan Pifer
George Romney
William Matson Roth
Althea T. L. Simmons
Leon H. Sullivan
David B. Truman

Commission Staff

Gabriel Rudney, Director of Research
Jeanne Moore, Executive Assistant
E. B. Knauft, Assistant to the Chairman
Judith G. Smith, Editor
Robert E. Falb, Co-Counsel
Stuart M. Lewis, Co-Counsel
Jerry J. McCoy, Co-Counsel
Samuel H. Black, Co-Counsel

Consultants

Howard A. Bolton
Wade Greene
Waldemar A. Nielsen
Stanley S. Surrey
Adam Yarmolinsky
Paul N. Ylvisaker

Special Consultants

James W. Abernathy
Martin S. Feldstein
Theodore J. Jacobs
Porter McKeever
Ralph L. Nelson
John J. Schwartz
Sally J. Shroyer
Carlton E. Spitzer

CONTENTS

VOLUME I

HISTORY, TRENDS, AND CURRENT MAGNITUDES

Part I

Commission on Private Philanthropy and Public Needs Commentary on Commission Recommendations

Donee Group Report and Recommendations

Page

Commission on Private Philanthropy and Public Needs Commentary on Commission Recommendations (1977) 3

I Broadening the Base of Philanthropy 3
  Commission Recommendation 3
    1. That to increase inducements for charitable giving, all taxpayers who take the standard deduction should also be permitted to deduct charitable contributions as an additional, itemized deduction.
  Commentary 3
  Commission Recommendation 4
    2. That an additional inducement to charitable giving should be provided to low- and middle-income taxpayers. Toward this end, the Commission proposes that a "double deduction" be instituted for families with incomes of less than $15,000 a year; they would be allowed to deduct twice what they give in computing their income taxes. For those families with incomes between $15,000 and $30,000, the Commission proposes a deduction of 150 percent of their giving.
  Commentary 4
  Commission Recommendation 5
    3. That income deducted for charitable giving should be excluded from any minimum tax provision.
  Commentary 5
  Commission Recommendation 8
    4. That the appreciated property allowance within the charitable deduction be basically retained but amended to eliminate any possibility of personal financial gain through tax-deductible charitable giving.
  Commentary 9

Page

Commission Recommendation 10

5. That the charitable bequest deduction be retained in its present form.

Commentary 10

Commission Recommendation 10

6. That corporations set as a minimum goal, to be reached no later than 1980, the giving to charitable purposes of 2 percent of pre-tax net income. Moreover, the Commission believes that the national commission proposed in this report should consider as a priority concern additional measures to stimulate corporate giving.

Commentary 11

II Improving the Philanthropic Process 11

Commission Recommendation 11

1. That all larger tax-exempt charitable organizations except churches and church affiliates be required to prepare and make readily available detailed annual reports on their finances, programs, and priorities.

Commentary 11

Commission Recommendation 16

2. That larger grant-making organizations be required to hold annual public meetings to discuss their programs, priorities, and contributions.

Commentary 16

Commission Recommendation 17

3. That the present 4 percent "audit" tax on private foundations be repealed and replaced by a fee on all private foundations based on the total actual costs of auditing them.

Commentary 17

Commission Recommendation 18

4. That the Internal Revenue Service continue to be the principal agency responsible for the oversight of tax-exempt organizations.

Commentary 18

Commission Recommendation 20

5. That the duplication of legal responsibility for proper expenditure of foundation grants, now imposed on both foundations and recipients, be eliminated and that recipient organizations be made primarily responsible for their expenditures.

Commentary 20

Commission Recommendation 22

6. That tax-exempt organizations, particularly funding organizations, recognize an obligation to be responsive to changing viewpoints and emerging needs and that they

Page

take steps such as broadening their boards and staffs to insure that they are responsive.

Commentary 22

Commission Recommendation 24

7. That a new category of "independent" foundation be established by law. Such organizations would enjoy the tax benefits of public charities in return for diminished influence on the foundation's board by the foundation's benefactor or by his or her family or business associates.

Commentary 24

Commission Recommendation 25

8. That all tax-exempt organizations be required by law to maintain "arms-length" business relationships with profit-making organizations or activities in which any member of the organization's staff, any board member or any major contributor has a substantial financial interest, either directly or through his or her family.

Commentary 26

Commission Recommendation 28

9. That to discourage unnecessary accumulation of income, a flat payout rate of 5 percent of principal be fixed by Congress for private foundations and a lower rate for other endowed tax-exempt organizations.

Commentary 28

Commission Recommendation 30

10. That a system of federal regulation be established for interstate charitable solicitations and that intrastate solicitations be more effectively regulated by state governments.

Commentary 30

Commission Recommendation 34

11. That as a federal enforcement tool against abuses by tax-exempt organizations, and to protect these organizations themselves, sanctions appropriate to the abuses should be enacted as well as forms of administrative or judicial review of the principal existing sanction—revocation of an organization's exempt status.

Commentary 34

Commission Recommendation 36

12. That nonprofit organizations, other than foundations, be allowed the same freedoms to attempt to influence legislation as are business corporations and trade associations, that toward this end Congress remove the current limitation on such activity by charitable groups eligible to receive tax-deductible gifts.

Commentary 37

Page

III A Permanent Commission 38
  Commission Recommendation 38
    That a permanent national commission on the nonprofit sector be established by Congress.
  Commentary 38
Footnotes 38

Private Philanthropy: Vital and Innovative or Passive and Irrelevant *The Donee Group Report and Recommendations* (1975) 49

Introduction 53
I The Basic Policy Issues 57
  The Perspectives of the Donee Group 57
  Commission Perspectives 60
    Perserving the Status Quo 60
    Failure to Assess Public Needs 62
    Fear of Government 62
    Excessive Confidence in Self-Regulation 63
II Recommendations 64
  Improving the Philanthropic Process 65
    Limit Donor Control 65
    Broadening Membership of Governing Boards 66
    Staffing is Essential 67
    Expanded Public Information Requirements 68
    Annual Public Meetings 69
    Eliminate Expenditure Responsibility 69
    Federated Fund Raising: Non-Exclusive Access; Prevent Conflicts of Interest; Reduce "Effective Donor" Control 70
  Redefining the Donor Community 71
    Charitable Deduction: Tax Credit Available to Everyone; Optional Tax Credit 72
    Minimum Tax Required 73
    Charitable Bequests: Minimum Estate Tax Required 74
    Tax Gifts of Appreciated Property 74
    Charitable Tax on Corporations 75
    Allow Exemptions Only on Property Used for Charitable Purposes 75
  Government Regulation of Philanthropy 76
    Remove Exempt Organizations Function from I.R.S. 76
    Congressional Oversight of Philanthropy is Necessary 78
    Limit Fund-Raising Cost 79
    Judicial Review of I.R.S. Determinations 80
    No Limits on Right to Receive Fees for Services 80
    Abolish the 4 Percent Excise Tax on Foundations 81
    Permanent Payout Rate of 6 Percent 81
  Exempt Organizations and the Public Process 81
    Remove Limitations on Lobbying 81

Page

    Donee Accountability Requirements ... 82
    Prevent Private Profit from Charitable Activity ... 83
    Revenue Sharing ... 83
Members of the Donee Group ... 84
Footnotes ... 85

Part II

History, Trends, and Current Magnitudes

Private Philanthropy and Public Needs: Historical Perspective *Robert H. Bremner* (1975) ... 89

Introduction ... 89
I The Roots of American Philanthropy ... 89
II Pauperism and Poverty ... 94
III The Gospel of Wealth and the Beginning of the Great Foundations ... 99
IV Philanthropy and/or Government ... 103
    Activist for the Insane ... 104
    Philanthropy in the Civil War ... 106
    The Peabody Education Fund ... 108
V Conclusion ... 111
Footnotes ... 113

Private Giving in the American Economy, 1960-1972 *Ralph L. Nelson* (1975) ... 115

Introduction ... 115
I The Growth in the Dollar Amount of Giving ... 116
    Philanthropic Product in the National Product ... 119
    The Quantity of Philanthropic Services Supplied to the Average American ... 121
II The Trend in Giving to Religion and in Giving to Purposes Other than Religion ... 122
III Trends in Giving by Living Donors, 1960-1972 ... 125
Appendix ... 130
Footnotes ... 133

The Scope of the Private Voluntary Charitable Sector *Gabriel Rudney* (1975) ... 135

I Concept of Scope ... 135
II Findings ... 136
III Measurement Concepts ... 138
IV Estimating Methodology ... 140

Page

Financial Data from Form 990 Returns for Exempt Charitable, Religious, and Educational Organizations and Private Foundations *John Copeland* (1975) 143

Introduction 143
- I Summary of Tabulations 145
  - Relationship of Foundation Data to Treasury Department Study for 1962 147
- II Distribution of Organizations by Asset Size 147

Appendix 153
Footnotes 154

Results from Two National Surveys of Philanthropic Activity *James N. Morgan, Richard F. Dye,* and *Judith H. Hybels* (1975) 157

Introduction 157
- I An Overview of Giving 159
  - Estimates of Aggregate Philanthropy 159
  - Gifts of Money and Property 160
  - Gifts by Donee 165
  - Time Given to Charitable and Religious Organizations 167
  - Volunteer Time by Activity and Organization 169
  - Time Helping Friends, Neighbors, and Relatives Outside the Household 172
  - Altruism as a Syndrome: The Complementarity of Time and Money Giving 173
- II Evidence on the Effects of Tax Policy 175
  - Knowledge and Sophistication 175
  - Attitudes 179
    - Effects of Deductibility 179
    - Stated Reasons for Changes in Giving 179
    - Reports by Those Respondents Who Have Started or Stopped Itemizing 179
    - A General Query 180
    - Some "Iffy" Questions on Prospective Response to Changes in Tax Laws 181
    - Summary of Knowledge and Attitudes 184
  - Behavioral Evidence of the Effects of Taxes on Giving 185
    - Nondeductible Gifts 185
    - Giving Beyond the Limit 185
    - Giving Appreciated Assets 186
    - Trusts, Foundations, and Charitable Bequests 188
    - Private Foundations 189
    - Past and Expected Change in Giving 191
    - Tax Effects on Current Giving 192
    - Combined Samples 195
    - A Path Analysis 195

Page

Summary 197
III Other Motives and Competing Goals 197
Expressed Motives 198
Attitudes of Those Who Gave $100 or More 200
Norms 203
Personal Involvement 204
Implied Motives 207
Type of Donee 208
Incentives for Giving Time and the Choice between Time and Money 209
The Relationship between Time and Money Giving 210
Summary of the Relationship between Time and Money Giving 215
Tax Exemption of Property Used for Religious, Educational, or Charitable Purposes 217
Other Motives for Giving Inferred from Correlations with Actual Giving 217
Giving/Expected Related to Various Characteristics 217
Background Factors and Dynamics 219
Environmental Influences and Reference Groups 221
Another Look at Variables Other Than Income, Age, and Education 221
Summary 224
IV Summary and Recapitulation 224
Tax Considerations 228
Other Factors 230
Implications for Policy 231
Appendix I: Sampling, Response Rates, Sampling Variability, and Possible Response Biases 233
Appendix II: The Estimating of Aggregates 236
Appendix III: The Relative Giving Variables 246
Appendix IV: Codebook with Frequency Tables 247
Footnotes 322

Employment and Earnings in the Nonprofit Charitable Sector
T. Nicholaus Tideman (1974) 325

Recent Trends in the Not-For-Profit Sector
Dale L. Hiestand (1975) 333

The Size of the Voluntary Nonprofit Sector: Concepts and Measures
Burton A. Weisbrod and *Stephen H. Long* (1975) 339

Introduction 339
I Economic Output Versus Input 339
II Some Alternative Measures 342
Volunteer Labor Services 342
New Estimates of Voluntary-Sector Money Flows 343

Page
Nonprofit Organizations 344
Private Foundations 348
III Conclusions and Recommendations 351
Appendix A 352
Appendix B: Sample of Tax-Exempt Organization Returns (IRS Form 990) 353
Appendix C: Direct Government Grants to Voluntary Sector Education and Health Institutions 356
Appendix D: Sample of Private Foundation Returns (IRS Form 990-PF) . 357
Footnotes 358
Bibliography 360

A Study of Religious Receipts and Expenditures in the United States
Interfaith Research Committee of the Commission on Private Philanthropy and Public Needs (1975) 365

Foreword 365
I Summary Report 367
Introduction 367
Diversity in the Religious Community 368
Charity and Benevolence 369
Survey Methodology 369
Projections 370
Religious-Related Agencies 371
Financial Receipts 371
Nonsacramental Expenditures 373
Congregations and Denominations 375
Financial Receipts 375
Nonsacramental Expenditures 376
Contributed Services 378
Composite Report 378
Financial Receipts 378
Nonsacramental Expenditures 379
II Report on Protestant and Orthodox Churches 380
Summary of Findings 380
General Description of the Protestant and Orthodox Communions . 381
Fund-Raising Procedures in the Denominations 383
Fund Raising for Church-Related Institutions 384
Attitudes Toward Giving 384
Survey Methodology 385
Analysis of Data 387
Income and Expenditures of Protestant and Orthodox Denominations 387
National Bodies 388
Regional Bodies 390
Local Churches 401

Page

Contributed Services for Nonsacramental Activities 407
National Church-Related Institutions 410
III Report on Catholic Agencies and Parishes 411
Catholic Agencies 411
Catholic Parish Data 421
Income 422
Nonsacramental Expenditures 424
Contributed Services 425
International Activities 426
IV Report on Jewish Agencies and Synagogues 426
Summary of Findings 426
Federations and Related Agencies Activities 426
Synagogue Activities 430
Summary of Findings 431
Survey Methodology 432
Income: Synagogues and Day Schools 433
Expenditures: Synagogues and Day Schools 434
Contributed Services 436
International Activities 436
Synagogue Movement Report 436
Reform: Union of American Hebrew Congregations (UAHC) . 436
Conservative: United Synagogue of America 438
Orthodox: Union of Orthodox Jewish Congregations of America (UOJCA) and National Council of Young Israel (NCYI) . . . 439
V Report on Morman Activities 440
Organization 440
Financial Support 441
Nonsacramental Activities 441
Appendix: Interfaith Research Committee Questionnaire Form 443
Footnotes 450

VOLUME II

PHILANTHROPIC FIELDS OF INTEREST

Part I

Areas of Activity

Private Philanthropy and Higher Education: History, Current Impact, and Public Policy Considerations *Earl F. Cheit* and *Theodore E. Lobman III* (1975) 453

Introduction 453
I Private Philanthropy and Higher Education: Historical Perspectives. 453
The Legacy of the Colonial Colleges 453

Page

An Overview of the Private Role, 1636-1974 456
Five Main Phases of the Private Philanthropic Role 461
    "Piety, Civility, and the Advancement of Learning," 1619-1776 461
    Diversity and Change, 1776-1862 462
    Giving for Future Use and Sharing Leadership with Government, 1862-1902 463
    The Era of Organized and Professional Philanthropy, 1902-1950 468
    Defining a Unique Role, 1950-1975 470
II Comparisons of Federal and Private Philanthropic Expenditures in Higher Education 471
Federal and Private Expenditures Compared 473
    Importance of Federal and Private Sources to Higher Education Purposes 475
    Importance of Federal and Private Sources to Different Types of Institutions 476
    Quality of Support 476
III The Structure of Private Support of Higher Education 479
Total Philanthropy and Higher Education 479
Sources and Purposes of Private Support of Higher Education 479
    Sources and Preferences 481
    Sources and Reasons for Giving 485
    Sources and Size and Form of Expenditures 487
    Sources and Purposes 488
    Type of Institution 489
Summary: The Form of Philanthropy Implies Its Importance 490
IV Private Philanthropy and Public Policy 491
The Need for Private Support of Higher Education 492
The Functions of Private Philanthropy 492
Philanthropy, Tax, and Education Expenditure Policy 494
A Framework for Policy Analysis 495
    Increased Tax Incentives for Philanthropy 496
    Decreased Tax Incentives for Philanthropy 496
    Decreased Tax Incentives and Decreased Federal Expenditures 497
    Decreased Tax Incentives and Increased Federal Expenditures 497
New Federal Expenditures and the Nine Functions 498
V Evolving Role of Private Philanthropy 501
Appendix: The Federal Role in Higher Education 504
Footnotes 507
References 510

Page

Philanthropy in Higher Education: Its Magnitude, Its Nature, and Its Influence on College and University Finance *Hans H. Jenny* and *Mary Ann Allan* (1975) 515

Introduction 515
Summary and Findings 516
I The Magnitude of Philanthropy in Higher Education 519
Who Receives Philanthropic Support? 519
What Does Philanthropy Support? 524
II What Is and Has Been the Influence of Voluntary Support on the Financial Health of Educational Institutions? 535
Inflation and Higher Education 536
The Need for Capital 540
The Student's Ability to Pay: The Tuition Gap 543
Private Philanthropy and Financial Distress in Institutions of Higher Education 547
III Some Speculations on the Future Impact of Private Philanthropy in Higher Education. 552
General Uncertainties 552
Uncertainties that Pertain to the Tax Reform Movement 553
Uncertainties Concerning Who Finances and Who Shall Receive Trusts 556
A Question of Political Philosophy and of Incentives 557
Appendix A: Listing of Carnegie Commission Classification of Institutions 559
Appendix B: Summary of Materials Received from Responding Institutions 560
Appendix C: Listing of the Three Samples of Institutions 578
Appendix D 581
Appendix E 586
Footnotes 592

Philanthropy, Public Needs, and Nonpublic Schools *Donald A. Erickson* (1974) 595

Introduction 595
I Public Benefits 596
II The Current Prospect 598
III Ameliorative Strategies 600
Strategy 1: Public Aid 600
Strategy 2: Interpret "Charitable Donations" Liberally 601
Strategy 3: Tax Credits or Deductions for Fees 601
Strategy 4: Education Vouchers 602
Strategy 5: "Private" Options in Public Schools 604
Strategy 6: Fee-Derived Support in Public and Nonpublic Schools. . 606

Page

IV Summary and Conclusions 607
Appendix 608
Footnotes 610

The Nonpublic School and Private Philanthropy *Robert L. Lamborn, Cary Potter,* and *Al H. Senske* (1974) 619

Introduction 619
I The Dimensions of Private Elementary and Secondary Education . . 619
 Enrollment and Classification 619
 Financial Dimensions 620
II The Public Purposes of the Nonpublic School 620
III Philanthropy and Its Relationship to the Nonpublic School 622
 Sources and Amounts of Philanthropy 622
 Philanthropic Support for Research and Program Development . . . 623
IV Analysis of Financial Operations and Philanthropic Support 624
 Financial Operations 624
 Philanthropic Support 628
 Patterns of Giving 628
V Conclusion 629
Footnotes 630

The Role of Private Philanthropy and Public Support of Science in the United States *Caryl P. Haskins* (1975) 631

Introduction 631
I Applied Science Versus Theoretical Science 632
 Pioneering Science and Technological Progress 634
II Public Versus Private Support of Science 635
 The Historical Record 635
 The Magnitude and Distribution of Public and Private Support . . . 637
 A Shared Mission 638

The Changing Role of Private Philanthropy in Health Affairs *Robert J. Blendon* (1975) 639

Introduction 639
I The Changing Role of Philanthropy 641
II Philanthropy Today 645
III Health Philanthropy Tomorrow 650
Appendix 653
Footnotes 654

Some Aspects of Evolving Social Policy in Relation to Private Philanthropy *Wilbur J. Cohen* (1975) 657

Introduction 657
I Social Policy and Philanthropy 658
 Trends in Social Policy 659

Page

Preventive Services 659
The Need for Private Voluntary Organizations 660
Financing to Meet Demand 661
State Responsibility 662
Purchase of Services 662
II Opportunities for Private Philanthropy to Meet Urgent Needs of the Next Decade 662
Early Childhood Education 662
Community Education Programs 663
Emergency Social Services 665
Services for the Aging 665
An Agenda for Private Philanthropy 667
III Preparing for Growth in Social Services 668
A Council of Social Advisers 668
Social Indicators 668
Financial Planning 669
The Congressional Budget 669
The Planning of Public and Private Spending 669
Need for Analysis of Philanthropic Expenditures 670
A New Role for the Private Sector 670
Evaluation 670
Voluntarism 671
Funding Patterns 671
A Role for Meeting Local Needs 672
Appendix A: Federal Grants to States for Social Services: Title XX of the Social Security Act 673
Appendix B: Public and Private Expenditures for Health, Education, and Welfare 674
Footnotes 674

Some Aspects of Private Philanthropy in Relation to Social Welfare
Ellen Winston (1975) 677

Introduction 677
I The Financing of Voluntary Social Welfare 678
II Sorting Out the Public and Private Role in Social Welfare Support 687
III Administrative Problems 688
Financial Aspects 688
Other Concerns 690
IV The Future 692
Appendix A: The Problem of Defining Social Welfare 693
Appendix B: Examples of Foundation Support for National Voluntary Social Welfare Agencies 694
Footnotes 695

Page

The Voluntary Social Agency Experiments, Innovates, Demonstrates, and Influences Public Social Policy: The Community Service Society of New York, 1930-1970 *Joseph L. Vigilante* and *Ruth Kantrow* (1974) . . 697

Introduction 697
I A Brief History of The Community Service Society 698
Functions of the Voluntary Social Agency 699
II Themes of Service and Activities of the Community Service Society 700
Responsiveness to Community Needs 701
Innovation and Experimentation 703
Emphasizing Quality Rather Than Quantity of Service 704
Mobilization of the Community to Address Social Problems 705
The Monitoring Function 706
III Findings and Recommendations 707
IV Summary 710
Footnotes 711

A Report on the Arts *Caroline Hightower*, for Associated Councils of the Arts (1975) 713

Introduction 713
I The Need for the Arts 714
II Why the Arts Are in Financial Trouble 715
The Critical Mix of Private and Public Support 716
The Need for More Information to Aid the Industry and Inform the Public 717
III Expenditures of Arts Organizations 718
IV Income of Arts Organizations 719
The Earnings of Arts Organizations: When Success Doesn't Pay for Itself 719
Private and Government Funding: An Important "Mix" with Roles Unresolved 721
Contributions from Individuals 722
National Foundations 723
Local Foundations 724
Corporate Support 724
Community Arts Councils 725
Government Support 725
V In Summary 727
Appendix A 728
Appendix B: The Cash Reserve Program of The Ford Foundation; The Dance Touring Program of the National Endowment for the Arts; Cincinnati: A Successful Fund-Raising Campaign 728
Appendix C 732

Page

The Role of Philanthropy In the Environmental Field: Preservation of Natural Lands and Historic Properties *Janet Koch* with *Thomas W. Richards* (1975) 735

I Some Reasons for Preservation 735
  Wilderness and Wild Things 735
  Remnants of History 736
II Public Actions and Private Organizations 736
  Government Programs 736
  Private Efforts 738
III Private Initiatives 738
  Acquiring Land 738
  Preserving History 740
  Guarding What We Have Saved 741
IV Changing the Tax Code 742
  Gifts of Property 742
  Matching Governmental Appropriations 744
  Tax Changes for Environmental Protection 744
V Speculating Costs 745
  Inventories 745
  Acquisition 745
  Guardianship 746
  Maintenance 747
Appendix A: Government Programs 747
Appendix B: Private Organizations 749
Footnotes 751

The Role of Private Philanthropy in Relation to Environment-Pollution *Blair T. Bower* (1975) 753

I Definition of Sector 753
II Evolution of Private Philanthropic Activity in the Environment Sector 753
III Role of Private Philanthropy in the Sector Environment-Pollution 754
  Research 754
  Monitoring Implementation 756
  Summary 757
Appendix 757

Philanthropic Activity in International Affairs *Adam Yarmolinsky* (1975) 761

Introduction 761
I Private Foreign Aid 763
  A Little History 763
  The Shape of Private Foreign Aid Today 767
    Disaster Relief 769

Page

Refugee Relief 769
Food Aid 769
Development Assistance 771
Why Private Foreign Aid? 774
The Legal Issues 778
II International Affairs Education and Research 779
University Programs 780
Independent Research Institutions 785
International Affairs Education Outside the University 787
Common Problems 790
Footnotes 792

Private Philanthropy and Public Affairs *Jane H. Mavity* and *Paul N. Ylvisaker* (1975) 795

Introduction 795
I Concepts, Categories, and Cases 797
Public Affairs as Process 797
Philanthropy as a Private Version of the Legislative Process 798
Philanthropy as a Private Version of the Administrative Process . . 798
Philanthropy as a Social and Political Process 799
Philanthropy as Historical Process 800
Public Affairs as a Philanthropic Category 800
Four Principal Purposes of Public Affairs Giving 802
Concluding Note 810
II Historical Perspective 811
Overview 811
Early Philanthropists in Public Affairs 811
Foundations in Public Affairs 811
Public Affairs Philanthropy in the 1960s 814
A Note on Current Trends 815
III The Logic and Counterlogic of Philanthropy's Role in Public Affairs 816
Introduction 816
The Logic of Private Philanthropy in Public Affairs 816
Counterlogic and Resistance to Private Philanthropy's Intervention in Public Affairs 819
IV The Tax Reform Act of 1969, and After: "Bringing Logic and Counterlogic Together" 822
TRA's Impact on Philanthropic Practice 822
TRA and the Question of Public Accountability 824
V After 1969 – An Intermediate View 825
Issue #1: Should the congressional charter of private philanthropy (the Tax Reform Act of 1969) be rewritten in more affirmative

Page

terms, to encourage greater and livelier use of American philanthropy's potential? 825
Issue #2: Is the contribution of private philanthropy to public affairs worth the loss of public taxes involved in getting it? 828
Issue #3: Is private philanthropy prepared to engage in public dialogue and deal with the gut-level questioning of its value and effectiveness? 829
Concluding Note 829
VI The Broader Context and the Longer Range 830
The Language Barrier 830
The Problem of Narrow Perspective: The Tax Peephole 830
Question: Should Philanthropy be Further—or at all—Associated with Favored Tax Treatment? 831
Question: What are the Touchstones for Deciding? 831
Question: Are Philanthropy's Sources of Support in Proper Balance? 832
Tensions and Trade-Offs Between Private Giving and Governmental Support 833
Resolution: Long-Term Prospects and Concerns 833
In Benediction 835
Footnotes 835

A Survey of the Voluntary Action Center Network *National Center for Voluntary Action* (1975) 837

Issues and Problems Facing the Voluntary Sector: A Survey of Leadership Opinion *Gordon Manser* (1975) 843

Introduction 843
I Survey Findings 845
Public/Voluntary Relationships 845
Revenue 847
Federal Tax Policy 847
How the Voluntary Sector will Respond 848
Citizen Participation 848
Better Understanding 849
Better Management 850
Foundation Responsiveness 850
Planning 850
Accountability 850
II Conclusion 851

The Voluntary Sector: Problems and Challenges *Pablo Eisenberg* (1975) 853

Introduction 853
I The Expanding World of Private Organizations 854
II The New Federalism and Government Power 855

Page

The Need for Community-Based Organizations 857
National Problems and the Need for National Organizations 858
III The Foundations and Their Priorities 859
The Responsibilities of Other Voluntary Organizations 860
IV Relationship Between the Private and Public Sectors 861
Research Needs 863

A Study of the Quantity of Volunteer Activity of United Way and Its Member Agencies *United Way of America* (1974) 865

Introduction 865
I Basic Data 867
II Estimation of Total Volunteer Hours 868
III Findings 869
Relationship of Program Service to Auxiliary Time 869
Ratio of Volunteer to Paid Professional Time 870
Volunteer Time and Community Size 871
Program Service Intensity 871
Allocation of Manpower 872
Appendix: List of Cities Participating in Study 874
Footnotes 875

A Philanthropic Profile of Four Cities: Atlanta, Cleveland, Des Moines, Hartford (1975)

Summary *Institute of Public Affairs, Inc.* 877

Private Philanthropy in Metropolitan Atlanta *The Institute for Social Research, Inc.* 883

I Private Nonprofit Agencies in Atlanta 883
Private Colleges and Universities 884
Private Primary/Secondary Schools 885
Private Recreation Agencies 885
Hospitals 887
Other Health Services 887
Social Services 889
Cultural Institutions 890
II Granting Practices of Foundations in Atlanta 891
Construction and Program 891
Capital Expansion Fund Recipients 891
Program Grant Recipients 891
Foundation Philosophy and Direction 892
Granting Practices of Foundations 893
III Granting Practices of Corporations in Atlanta 895
Construction and Program 895
Capital Expansion Fund Recipients 896

Page
Program Grant Recipients 896
Granting Practices of Corporations 897

A Philanthropic Profile of the Cleveland Metropolitan Area, *Human Services Design Laboratory* 899

Survey Methodology 899
I Cleveland Philanthropic Profile: Recipients' Source of Income 900
Findings 901
General Breakdown of Income Sources 903
Breakdown of Income Sources by Individual Category 909
Education 912
Cultural Affairs 912
Health 913
Social Services 915
Civic Affairs 917
II Cleveland Philanthropic Profile: The Recipients' Viewpoint 917
Findings 919
Funding Trends 919
The Role of Volunteers and Impact of Funding Sources on Their Involvement 919
Impact of Funding Sources on Agency Operation 919
Responsiveness of Funding Sources to Public Need 920
Conclusions 921
III Cleveland Philanthropic Profile: Donor Allocations 923
Findings 923
IV Cleveland Philanthropic Profile: The Donors' Viewpoint 925
Findings 928
How Have Local Patterns of Philanthropy Changed in the Past Two to Three Years? 928
Are Local Mechanisms for Setting Priorities Satisfactory and Do They Provide Adequate Community Involvement? 930
Are Local Foundations Meeting Their Responsibilities to the Community? 930
In What Areas of Human Services Should Foundations Have Greater Financial Involvement? 931
How Has Government Support of Human Service Organizations Affected Philanthropy in the Cleveland Metropolitan Area? 932
What Would Be the Impact of Changes in Federal Tax Laws Affecting the Deductibility of Charitable Donations? 933
What Is the Nature and Extent of Non-Financial Philanthropic Efforts and How Are They Related To Opportunities and Incentives for Financial Philanthropy? 933
V Summary and Conclusions 934

Page

Philanthropic Profile of Metropolitan Des Moines *United Way of Greater Des Moines, Inc.* 937

Survey Methodology 937
- I Survey Findings 939
- II Financial Data 942
  - Corporations and Foundations 948
  - United Way 950
  - Five Large Organizations 952

Philanthropic Profile of the Connecticut Capitol Region *The Community Council of the Capitol Region* 953

- I Agency Fiscal Survey 953
- II The Agency Perspective 953
  - Findings 954
    - Trends in Public Funding 956
    - The Voluntary Role and the Impact of Funding Sources on Volunteer Involvement 957
    - Impact of Funding Sources on Agency Operations 957
    - Responsiveness of Community Funding Sources to Public Need 957
    - The Role of the Private Sector Agency 958
- III Fiscal Survey of Private Funding Organizations 958
- IV The Funders' Perspective 959
  - The Effect of Tax Laws on Philanthropic Contributions 962
  - The Role of Philanthropic Money 962
  - Philanthropic Giving and Public Priorities 962

The Anatomy of Giving: Five American Cities (1975)

A Preface *Bice Clemow* 963

Search for the Bridge: The Stand-Off Between City Hall and "Five Points" in Atlanta *Bice Clemow* 969

Cleveland: Faint Halo Around a Solid Tradition of Giving *Robert S. Merriman* 985

Private Philanthropy in Des Moines *Calvin Kentfield* 995

Money Above, Action Below: Philanthropy in Hartford *Vivian Gornick* . 1003

Passing the Buck: Philanthropy in San Francisco *Jack Shepherd* 1017

Page

Part II

Additional Perspectives

An Agenda for the Future
Reynold Levy and Waldemar A. Nielsen (1975) 1029

Introduction 1029
I The Need for Information, Analysis, and Ideas 1030
Special Problems and Needs of the Social Action Movement 1031
The Impacts of Stag-Flation on the Private, Nonprofit Sector 1033
II The Need for New Approaches to the Intensifying Issues at the Interface with Government 1034
The Fearful Assymetry 1035
The Obscure Limits to Interpenetration 1037
The Task of Role Clarification 1038
Government Contracting and Grant Making—the Crucial Transactions 1041
The Need for Structural Reforms in Government 1043
The Executive Branch 1043
The Role of Congress 1046
III The Need for Overhauling and Reinforcing the Third Sector 1047
The Need for More Resources 1050
Stimulating Private Giving 1051
Individual Giving 1051
Corporate Philanthropy 1052
Generating Greater Government Support 1054
The Need to Broaden Public Support and Participation 1056
Some Reasons for Hope 1061
IV The Need to Create a New Public Foundation for the Private Nonprofit Sector 1064
Footnotes 1065

Public Needs, Public Policy, and Philanthropy: An Analysis of the Basic Issues and Their Treatment by the Commission on Private Philanthropy and Public Needs *Thomas R. Asher* (1975) 1069

Introduction 1069
I Public Needs: An Overview 1072
II The Evolution of America's Egalitarian Values 1073
III Citizen Empowerment: The Public Need Addressed by the Public Interest Movement 1075
Leverage in Philanthropic Giving 1076
The Movement for Political Equality 1076
Financing Citizen Empowerment 1081
IV Conclusion 1085
Footnotes 1089

Page

Values, Voluntary Action, and Philanthropy: The Appropriate Relationship of Private Philanthropy to Public Needs *David Horton Smith* (1975) 1093

Introduction 1093
I Values and Needs, Public and Private 1094
II Basic Public Needs 1096
  Physical and Mental Health 1096
  Economic Well-Being 1097
  Justice, Security, and Freedom 1097
  Education and Communication 1098
  Science, Technology, and Inquiry 1098
  Religion, Philosophy, and Idealism 1098
  Peace and Social Integration 1099
  Esthetic Experience, "Culture," and Entertainment 1099
  Leisure and Recreation/Relaxation 1099
  Emotional Expression and Interpersonal Relations 1100
  Participation, Involvement, Efficacy, and Power 1100
  Ecological Balance and a Decent Environment 1100
  Social Welfare and Social Services 1100
  Social Change and Adaptation 1101
  International Perspective and Relations 1102
III Validity of the Public Needs List 1102
  Relation to Implicit Filer Commission Public Needs List 1104
  Relation to Filer Commission Final Report and Recommendations 1107

Philanthropy and the Powerless
Sarah C. Carey (1975) 1109

Introduction 1109
  New Trends in Giving to the Powerless 1111
  Philanthropic Assistance to the Powerless: What Tactics Work 1114
I Changing the Economic Plight of the Poor 1116
  Advocacy for the Poor 1117
    The Welfare Rights Movement 1117
    Hunger and Malnutrition 1120
  Cooperatives, Community Development, and Minority Businesses 1122
    Corporate and Rural Programs 1122
    Minority Business and Urban Economic Development 1123
II Grants to Mexican-Americans and Indians 1124
  Mexican-Americans 1124
    Mexican American Legal Defense and Education Fund (MALDEF) 1125
    Organizers and Community Developers 1125
    Attitudes of Chicano Grantees 1128

Page

American Indians 1128
The Powers of the Tribe 1130
The Rights of Indians Without Tribal Status 1130
The Protection of Tribal Land and Resources 1131
Education and Culture 1132
III Political Participation and the Reform of Governmental Institutions 1133
Voting Rights and Voter Education 1134
School Finance Reform 1137
IV Revitalizing Rigid Institutions to Serve Their Clients or Members 1139
Union Reform: The Case of the United Mineworkers 1139
V A Special Look at Church and Corporate Giving 1141
The Churches 1141
Special Funds 1141
General Welfare Support 1143
Peace Activities 1144
The Corporations 1144
Background 1144
Examples of Corporate Philanthropy 1148
VI The Youth Project: A Mechanism To Assist Donors in Reaching Powerless and Social Activist Groups 1151
VII Recommendations 1153
Appendix: List of the "Activist" Foundations 1155
Footnotes 1157

U.S. Foundations and Minority Group Interests
U.S. Human Resources Corporation (1975) 1165

Introduction 1165
Research Focus and Mehodology 1165
U.S. Human Resources Corporation 1166
Summary 1167
Recommendations 1169
I Identifying Foundations 1172
Definitions of Foundations 1172
Types of Foundations 1174
Number of Foundations 1175
Growth and Assets of Foundations 1176
Trends in Foundation Grant-Giving 1177
Foundation Grants Compared With Federal Expenditures 1180
II Grants Data 1181
Methodological Note 1181
Grant-Giving Patterns to Programs Benefiting Domestic Spanish Heritage Populations 1183
Grant-Giving Patterns to Programs Benefiting Domestic Asian American Populations 1188

Page

Summary 1192
III American Philanthropy and the Public Interest 1193
Rationale for Private Foundations–General Policy Issues 1193
Public Policy and Tax Incentives for Private Philanthropy 1195
The Tax Reform Act of 1969–Legal Constraints and Policy Issues 1197
The TRA and Grant-Making Policies Affecting Minorities 1198
IV Mission and Program of Foundations–Foundation Involvement in Institutional Change 1201
Historical Antecedents 1201
Survey Data Relating to Institutional Change 1204
Reactions of Ethnic Minority Leaders and Ethnically Oriented Organizations 1206
Institutional Change-Oriented Projects as Perceived by Foundation Spokesmen 1211
The Governmental View of Foundations' Role in Institutional Change 1214
Other Views of Foundation Participation in Institutional Change . . 1215
V Programs and Viewpoints Relating to Minorities–Foundation Involvement in Political Processes, High-Risk Projects, and Cultural Hospitality 1225
Foundation Involvement in Studies or Actions Affecting Governmental Structure, Policies, Programs, and Political Processes 1225
  Native American Control of or Influence on School Boards . . 1225
  Public Attitudes Toward Foundation Involvement in Public Affairs 1226
  Views of Americans Attending the Anglo-American Conference on the Role of Philanthropy in the 1970s . . . 1228
Financing High-Risk Projects, Groups, or Organizations with No Established Track Record 1228
  Perspective of Scholars and a Professional Organization 1228
  Views of a Public Official and of a Minority Spokesman 1229
  Foundation Perspectives 1230
Allocating Resources to Programs for Poor or Disadvantaged Individuals and Groups, Ethnic Minorities–Cultural Hospitality in Grant-Making 1234
  A Venture to Increase the Number of Black Lawyers Practicing in the South 1237
  Foundation Help for the Medical Education of Ethnic Minorities 1239
  Grant-Making to Native Americans 1239
  Perspectives of Ethnic Minority Spokesmen 1241

Page

VI Administrative and Structural Policies Relating to Minorities 1243
Trustees 1243
Staffing 1246
Dissemination of Information and Technical Assistance 1249
Appendix 1253
Bibliography 1265
Footnotes 1269

Philanthropic Foundations of the U.S. and their Responsiveness to the Special Needs, Problems, and Concerns of the Hispanic Community: 1960 Through 1971 *The National Council of La Raza* (1975) 1283

Introduction 1283
I Survey of Literature 1284
II Demographic, Social, and Economic Characteristics of the Spanish-Origin Population of the United States 1288
III Research Methodology 1292
IV Findings 1293
V Conclusion 1300
Bibliography 1300
Footnotes 1302

The New Federalism: Government Accountability and Private Philanthropy *Peter J. Petkas* (1975) 1305

Introduction 1305
I The New Federalism 1305
II The Quasi Governments 1308
III The A-95 Review Process 1309
IV State, Local, and Private Accountability Mechanisms 1310
V The Accountability Gaps: Experience Has Been No Guide 1311
VI Citizen Groups in the South 1314

The Role of Foundations in Broadcasting and Cable Communications Policy Development *Albert H. Kramer* (1975) 1317

Introduction and Summary 1317
I The Foundations' Greatest Effort at Meeting Public Needs in Broadcasting 1318
II Foundation Support of the Challengers 1320
The Success Stories 1321
Office of Communication of the United Church of Christ 1321
Citizens Communications Center 1321
Action for Children's Television 1322
Media Access Project 1323
The Might-Have-Beens 1324

Page

The "Counter-Ad" Movement and Its Evolution 1324
Black Efforts for Soul in Television 1327
An Advocacy Movement Responsive to Public Needs 1328
III The Current Reaction to Efforts to Meet Public Needs in Communications 1330
Some "May-Becomes" in the Broadcasting Area 1330
The National Citizens Committee for Broadcasting 1330
The Alabama Educational Television Commission 1332
Cutting the Cable 1333
The Federal Level 1335
The Local Level 1336
Meeting Public Needs in Cable Policy 1338
IV Conclusion 1339
Appendix 1340
Footnotes 1341

Foundation Grants to Corporate Activist Groups: The Donee Perspective *Philip W. Moore* (1975) 1343

Introduction 1343
I Corporate Activist Groups: Background 1344
II The Project on Corporate Responsibility 1345
III Council on Economic Priorities 1347
IV The Interfaith Committee on Corporate Responsiblity 1349
V Other Corporate Activist Groups 1350
VI Conclusion 1351

The Role of the United Way in Philanthropy
David Horton Smith (1975) 1353

Introduction 1353
I Fund Raising and Resource Attraction 1354
II Governance 1363
III Access to United Way Funds 1373
IV Allocation, Accountability, and Planning 1378
Allocation of United Way Funds 1378
Accountability in the United Way System 1379
Priority Planning and Public Needs 1380
V Conclusion 1380
Footnotes 1381

Who's Funding the Women's Movement?
Mary Jean Tully (1975) 1383

Patterns of Ethnic and Class Discrimination in the Corporate and Philanthropic World *Geno Baroni, Arthur Naparstek,* and *Karen Kollias* (1975) 1385

VOLUME III

SPECIAL BEHAVIORAL STUDIES, FOUNDATIONS, AND CORPORATIONS

Part I

Special Behavioral Studies

Page

Tax Incentives and Charitable Contributions in the United States: A Microeconometric Analysis *Martin S. Feldstein* and *Charles Clotfelter* (1975) 1393

Introduction 1393
I Data, Specification and Definitions 1394
II The Basic Parameter Estimates 1397
III Additional Specifications and Tests 1401
Taxpayers with Itemized Deductions 1401
Aged and Nonaged Taxpayers 1401
Other Demographic and Economic Factors 1402
IV Varying Price Elasticities 1403
V Interdependence Among Individuals in Charitable Giving 1407
VI Simulated Effects of Alternative Tax Changes 1409
VII Conclusion 1413
Footnotes 1413

The Income Tax And Charitable Contributions: Estimates And Simulations With The Treasury Tax Files *Martin S. Feldstein* and *Amy Taylor* (1975) 1419

Introduction 1419
I Specification and Data 1419
II The Basic Cross-Section Estimates 1422
III The Effects of Changes in Tax Rates 1425
IV Estimating Separate Price Elasticities by Income Class 1429
V Simulated Effects of Alternative Tax Changes 1431
VI Conclusion 1437
Footnotes 1438

Effects of the Charitable Deduction on Contributions by Low-Income and Middle-Income Households: Evidence from the National Survey of Philanthropy *Michael J. Boskin* and *Martin S. Feldstein* (1975) 1441

Introduction 1441
I The Data 1442
Charitable Contributions 1442
Price 1442
Income 1443

Page

Age 1443
Other Variables 1443
II The Basic Results 1443
III Estimating the Price Elasticity by Income Class 1446
IV Is There an Itemization Effect? 1448
V Conclusion 1449
Footnotes 1450

Estate Taxation and Charitable Bequests
Michael J. Boskin (1975) 1453

Introduction 1453
I A Model of Lifetime Charitable Contributions and Charitable Bequests 1454
II A Cursory Discussion of Previous Studies, Estimation Problems, and Data 1458
Previous Studies 1458
Estimation Problems 1459
Sources of Data 1461
Definition of the Variables 1461
III Empirical Results: 1957-59 Special Study Data 1464
IV Empirical Results: 1969 Data 1469
V The Effect of Alternative Estate Tax Reforms on Charitable Bequests 1473
VI Caveats and Conclusions 1479
Footnotes 1480

Charitable Bequests, Estate Taxation, and Intergenerational Wealth Transfers *Martin S. Feldstein* (1975) 1485

Introduction 1485
I Data and Measurement 1486
II Effects of Price and Estate Size 1488
III Behavior of Large Estates 1491
IV Bequests by Major Types of Donees 1493
V Concluding Remarks 1495
Footnotes 1500

A Note On the Estimation of Personal Giving
Ralph L. Nelson (1975) 1501

Evaluation of Econometric Research on the Income Tax and Charitable Giving *Arnold Zellner* (1975) 1515

Page

Charitable Contributions Under the Federal Individual Income Tax: Alternative Policy Options *George F. Break* (1975) 1521

Introduction 1521
I Major Policy Options 1522
  Extend the Charitable Deduction to All Taxpayers 1522
  Place Maximum Limits on the Charitable Deduction 1524
  Compulsory Allocation of Charitable Deductions 1525
  Restrict Deductions for Appreciated Assets to Cost Basis 1525
  Tax Unrealized Appreciation on Property Contributions as a Long-Term Capital Gain 1527
  Eliminate the Charitable Contribution Deduction 1529
  Substitute a Single-Rate Tax Credit for the Charitable Contribution Deduction 1530
  Enact an Optional Tax Credit for Charitable Contributions 1533
  Place a Floor Under Deductible Charitable Contributions 1535
II Mixed Policy Options 1536
Footnotes 1537
Bibliography 1538

Part II

Foundations

The Public Funding Agency *Eric Larrabee* (1975) 1543

Private Foundations and the 1969 Tax Reform Act *Chairman and Staff, Council on Foundations, Inc.* (1975) 1557

Introduction 1557
I General Background and Rationale 1557
  Brief History 1557
  Rationale 1559
II Dimensions of the Foundation Field and Program Trends 1560
  Types of Foundations 1560
  Assets and Their Distribution 1561
  Distribution and Trends by Fields 1562
  Matters of Scale and Impact 1563
III The 1969 Tax Reform Act and Its Effects 1564
  Summary of Principal Provisions 1564
  1974 Council on Foundations Survey 1565
  The Effects of the Act 1565
    The Tax on Investment Income 1565
    Administrative Costs and Staffing 1566
    Reporting to the Public 1568
    The Pay-Out Requirement 1568

Page

Program Restrictions 1571
Excess Business Holdings 1572
IRS Supervision 1572
Birth and Death Rates 1573
IV Endeavors and Accomplishments 1576
Large Doings of the Past 1577
ETV: A Case History 1578
Regional Examples 1580
Relations to Government 1583
V Critical Issues: Pro and Con 1584
Post-1969 Perspective 1584
Critics on All Sides 1585
Accountability 1585
Accessibility 1586
Donor Influence 1586
"Whose Money and To What Effect?" 1588
Reaffirmation 1590
VI Recommendations 1591
To Foundations 1591
"Not Our Money But Charity's" 1592
Periodic Review of Objectives and Activities 1592
Extending the Perceptions of Boards and Staffs 1592
Informing the Public 1592
Responsibilities to Applicants and Grant Recipients 1592
Assessing the Responsibilities and Capabilities of Both Trustees and Staff 1593
Increasing Communications and Cooperation 1593
Making the Charitable Dollar Make a Difference 1593
Recommendations Relative to the 1969 Act and Other Issues 1593
On the 4 Percent Tax 1594
On the Level of Required Pay-Out 1595
On Special Limitations Affecting Gifts to Foundations 1595
On Certain Divestiture Requirements 1596
On Program Restrictions 1597
On the Issue of Limited Life 1597
On Supervision 1598
Appendix A: Growth and Dimensions of the Foundation Field 1599
Appendix B: Council on Foundations Survey of the Effects of 1969 Tax Reform Act Among Private Foundations 1613
Appendix C: *Reasonable Investment Expectations and the Payout of Private Foundations* J. Peter Williamson 1648
Footnotes 1653

Page

Pay-Out Requirements for Foundations *Eugene Steuerle* (1976) 1663

Introduction 1663
- I Historical Review 1663
- II Equity and Efficiency of Current Distributional Requirements . . . 1666
  - Horizontal Inequity in Distributional Requirements 1666
  - Deficiencies of the Current Formula 1666
  - Instability of Distributions 1667
- III Recommendations for Revision in Requirements for Distribution . . 1668
- IV A Question of Perpetuity 1671
  - Growth of Individual Foundations 1671
  - A Model of Foundation - Sector Growth 1672
- V The Effect of Distributional Requirements for Foundations Upon the Charitable Sector 1676
- VI Conclusion 1677

Footnotes 1677

Foundations and the Federal Government: A Look at Spending Patterns *Michael S. Koleda, Daniel Bourque,* and *Randall Smith* (1975) . 1679

Introduction 1679
- I Health 1680
- II Education 1681
- III Science 1683
- IV Social Welfare Services 1684
- V Arts and Humanities 1685
- VI Public Affairs 1686

Appendix 1687

Community Foundations *Norman A. Sugarman* (1975) 1689

- I Background 1689
  - A Brief History of the Community Foundation Movement 1689
  - Some Basic Data on Community Foundations 1691
  - Characteristics of a Community Foundation 1692
- II The Role of Community Foundations 1694
  - Operations of Community Foundations in General 1694
    - Structure for Attraction of Gifts or Bequests from the Public 1694
    - Efforts to Seek Public Support 1694
    - Types of Gifts or Bequests Encouraged 1695
    - Investments and Distributions 1695
  - The Role of Community Foundations in Community Public Service 1697
    - Community Foundation Distributions in General 1697
    - Uses of Community Foundation Grants 1697
    - Community Foundation Services in Utilizing Other Community Resources 1699

Page

III Community Foundations and the Tax Laws 1700
Pre-1970 Status of Community Foundations Under the Tax Law . . 1700
Classification of Foundations Under the 1969 Act; Application of Rules to Community Foundations 1701
Differences Between Community Foundations and Private Grant-Making Foundations 1702
The Importance of Public Charity Classification Under the 1969 Act 1704
IV Evaluation of Community Foundations: Current Issues and Future Role 1706
Current Issues Involving Community Foundations 1706
The Future Role of Community Foundations in Private Philanthropy 1709
The Community Foundation as a Prime Object of Philanthropic Giving 1710
Development of Associations of Foundations 1710
Conversion of Private Foundations into Supporting Foundations of Community Foundations 1710
Termination of Private Foundations into Community Foundations 1711
V Summary and Recommendations 1711
Appendix A: Geographical Listing of Community Foundations 1713
Appendix B: Financial and Other Data on Community Foundations . . 1719
Footnotes 1721

The Charitable Foundation: Its Governance *Lawrence M. Stone* (1975) 1723

Introduction 1723
I Long-Range Strategy 1724
II Some Specific Recommendations 1726
Areas of Appropriate Government Regulation 1726
Areas in Which to Avoid Government Regulation 1726
Areas of Experimentation With Different Regulatory Approaches. . 1726
Limits on Control But Not on Size 1727
Equal Tax Treatment for Foundations and Other Charitable Institutions 1727
III Areas of Potential Government Regulation: The Problem of "Privateness" 1727
Solicitation of Funds 1727
Selection and Composition of the Governing Board—Donor Control 1727
IV Private or Semigovernmental Regulation of Board Composition and Conduct 1730
V Community Foundations: An Inappropriate Model 1732

Page

VI Limitations on Minimum or Maximum Size 1733
VII Conclusions 1733
Footnotes 1734

Part III

Corporations

Corporate Philanthropic Public Service Activities *James F. Harris* and *Anne Klepper* (1975) 1741

Foreword 1741
I Introduction 1741
Corporate Roles and Philanthropy 1742
Corporate Contributions, 1936-1972 1743
Stockholder Influence 1743
Cost to Stockholders 1743
Survey Methodology 1745
II Leadership 1746
Involvement of Top Corporate Leaders 1746
The Corporation's Social Role 1747
Most Important Philanthropies 1747
Philanthropic Activities 1749
Some Leadership Examples 1749
The "Leading Edge" 1751
III The Reasons for Giving 1751
Personal Viewpoints 1753
The Pros 1754
The Cons - and the Maybes 1755
IV Factors Determining Budget Levels 1756
Industry Comparisons 1756
Recipient of the Corporate Dollar 1759
V Public Service Activities 1759
Costs 1759
Administration 1762
Company Facilities 1762
Miscellaneous Cost Data 1762
Areas of Corporate Involvement 1763
United Way 1763
Blood Banking 1764
Coordinated Business Approaches: Economic Development Council of New York City 1764
National Alliance of Businessmen 1765
Ten Areas That Receive Corporate Support 1765
Communications 1768

Page

VI Company Foundations, Taxes, and the Tax Reform Act of 1969 . . 1768
Effects on Existence of Company Foundations 1768
Effects of Specific Provisions 1769
Potential Effects of Alternative Tax Changes 1770
Other Factors Affecting Contributions 1773
Charitable Deductions and Business Expenses 1773
Charitable Contribution or Business Expense? 1775
VII Management and Staffing 1776
Contributions and Foundation Staff 1777
Accountability and Evaluation 1778
VIII Recommendations of the Business Advisory Committee 1778
Leadership 1779
Management and Staffing 1780
Accountability and Evaluation 1780
Communications and Public Disclosure 1781
Diversity 1781
Corporate Foundations 1781
Taxes 1782
Appendix 1784
Related Conference Board Publications 1787
Footnotes 1788

Corporate Giving: Rationale, Issues, and Opportunities *C. Lowell Harriss* (1975) 1789

Introduction 1789
Scope of Study 1789
Corporations as the Subject of this Report 1790
Rules and Attitudes Affecting Contributions Are Subject to Change 1790
Variety of Business Aids to Nonprofit Organizations 1790
Historical Background: A Brief Sketch 1791
Social Responsibility 1792
I Policy Considerations of Fundamental Importance 1792
". . . or to the People": The Bill of Rights and Voluntarism 1793
Maintaining and Enhancing Diversity, Flexibility, and Creativity in Service Delivery Systems: Corporate Personnel and Funds 1793
Preserving the Capacity of the Business World to Perform its Essential Functions 1795
Business as Existing at the "Toleration" of Society: A Misplaced Argument 1796
II Arguments For and Against Corporate Contributions 1797
Arguments Against – or for Narrow and Limited – Corporate Giving 1797
Profits Inadequate 1797

Page

Avoiding Confusion of the "Business" with Other Aspects of Social Activity 1798
Corporate Philanthropy as an Exercise of Undue Power 1798
Unreasonable Expectations 1799
Business Sticking to Business Will Provide Increasing Ability for Individuals to Finance Philanthropy 1799
Specialization 1799
Stockholder Decisions Preferable 1800
Competition Limits Ability to Contribute 1800
Doubt About Worth of Results 1800
Company Could Not Give Enough to Make Any Difference . . 1800
Peers and Others Not Giving More 1801
Stockholder Objections 1801
Arguments in Favor of (Larger) Corporate Giving 1801
Carrying on What Has Brought Good Results in the Past: Respecting an Obligation 1802
Voluntarism Aided by Corporate Giving 1802
Improving the "Climate" for Business 1803
Improving Community Conditions Can Help Employee Productivity 1803
Colleges and Universities Provide Training and Conduct Research 1803
Personnel from Businesses Can Supply Useful Skills 1804
Tax Interests of Shareholders Vary 1804
Building Public Respect 1804
Continuation of Contributions Practices: Commitment 1805
Diversification as a Reason for Shareholders to Support Corporate Contributions 1805
Economy in Raising Funds 1805
Externalities 1806
III Tax Considerations 1808
High Tax Rates 1808
Tax Expenditures 1808
Difference Between Personal and Corporate Contributions 1809
Self-Interest Element of Business Contributions 1810
Cost of Deductible Gifts 1811
IV The Record: Statistics and Commentary 1812
Historical Record 1812
1970 Figures 1813
Other Evidence 1815
Judging Results 1815
V Increasing Corporate Contributions 1816
How Much Might Be Expected? 1816
Profitability of Business 1818
Possibilities of Government Action 1818

Page

Raising the 5 Percent Limit 1818
Deduction of More Than the Amount of the Contribution . . . 1819
Increasing the Value of Deduction by Corporations Not Subject to 48 Percent Rate 1819
Tax Credit 1819
Establishing a Contributions Floor 1820
Adjustments for Industries and Companies That Differ from the Average 1821
Valuation of Gifts from Inventory 1821
Actions in the Private Sector 1821
Footnotes 1822

Corporate Charitable Contributions and Corporate Social Responsibility *Milton Moskowitz* (1975) 1827

Corporate Giving Measures *Thomas Vasquez* (1975) 1839

I Development of Corporate Giving, 1935-1970 1839
II Cross-Sectional View of Corporate Giving, 1970 1843
Footnotes 1852

Corporate Charitable Contributions *R. Palmer Baker, Jr.*, and *J. Edward Shillingburg* (1975) 1853

Introduction 1853
I Corporation Law and Tax Framework 1854
Historical Background 1854
Present Corporate Law Situation 1854
Business Corporations 1854
Regulated Industries 1855
Present Tax Law 1856
II The Sources and Recipients of Corporate Contributions 1857
Rate of Giving 1857
Recipients 1858
III Company Foundations 1859
Use of Company Foundations 1859
Effect of Recent Legislation 1859
IV Other Corporate Support 1864
Gifts in Kind 1864
Personal Services 1865
V Corporate Giving: Part of Corporate Social Responsibility 1865
VI A Rationale for Corporate Philanthropy 1866
VII Recommendations 1870
Changing Concepts of Charity 1870
Corporate Law 1870

Page

Regulated Utilities . . . 1870
Tax Considerations . . . 1870
Appendix A: *Ohio Citizens' Council for Health and Welfare v. The Public Utilities Commission of Ohio* . . . 1871
Appendix B: New York State Bar Association, Tax Section, *Proposals for Improvement of Rules for Allocation of Deductions Between Foreign and U.S. Source Income* . . . 1874
Appendix C: John H. Watson, III *Biennial Survey of Company Contributions*, The Conference Board (1973) . . . 1875
Footnotes . . . 1903

VOLUME IV

TAXES

Part I

Exemption and Deduction

Criteria for Exemption Under Section 501(c)(3) *John P. Persons, John J. Osborn, Jr., and Charles F. Feldman* (1976) . . . 1909

Introduction and Summary of Report . . . 1909
I Historical Origins of Section 501(c)(3) . . . 1911
The Development of the Legal Definition of Charity in England . . . 1912
The English Origins of Special Legal Institutions and Rules Developed to Enable Charity to Accomplish Its Objectives . . . 1916
The English History of the Regulation of Charities to Prevent Abuses . . . 1917
The History of the Tax Exemption of Charities in England . . . 1919
Property Taxation . . . 1919
Income Tax . . . 1919
The Legal History of Charities in America . . . 1920
The Colonial Experience . . . 1920
The Development of Vehicles for Conducting Charitable Activities . . . 1921
The Tradition of Exempting Charitable Organizations from Tax Under State and Local Law . . . 1923
The History of the Exemption of Charities From Federal Taxation . . . 1924
II Rules Applying to All 501(c)(3) Organizations . . . 1925
Requirements Pertaining to the Founding Document and Form of Organization . . . 1926

Page

Requirements Affecting Day-to-Day Operations of 501(c)(3) Organizations 1928
Requirements Pertaining to Legislative and Political Activities of 501(c)(3) Organizations 1929
III The Search for a Modern Definition of Charity Under Section 501(c)(3) 1932
Attempts to Define "Charity" 1933
The Evolving Nature of "Charity" 1934
Principles that Guide the Evolution of "Charity" Under Section 501(c)(3) 1938
Does the Organization Meet a Recognized Need of the Community (Or an Appropriate Segment Thereof) That Would Not Otherwise Be Met Through the Functioning of the Commercial Market 1938
Are the Means Used By the Organization to Achieve Its Charitable Purposes Reasonably Related to the Needs That the Organization Is Seeking to Meet? 1944
Does the Organization Manifest the Characteristic of Unselfish Giving Which Has Traditionally Been Associated With Charity? 1945
Is the Organization Consistent with Law and Public Policy? 1950
IV Criteria Pertaining to Religious Organizations 1951
The Definition of "Religion" or "Religious Purposes" 1952
Activities of Religious Organizations Not Related to Worship 1955
Legislative and Political Activities of Religious Organizations 1957
V Criteria Pertaining to Educational Organizations 1963
The Element of Training or Instruction 1965
Criteria for Determining Whether Training or Instruction is "Educational" 1966
The Subject Matter of Instruction 1966
The Educational Method 1967
The Requirement of Full and Fair Exposition of the Relevant Facts 1968
Ancillary Activities in Furtherance of Education 1969
Incidental Noneducational Activities of an Educational Organization 1969
Noneducational Organizations That Advance Education 1970
Limits on the Concept of Advancement of Education Under Section 501(c)(3) 1970
VI Criteria Pertaining to Scientific Organizations 1971
The Meaning of "Scientific" 1972
"Scientific Research" Under Section 501(c)(3) 1973

Page

The Exclusion of Activities Incidental to Commercial or Industrial Operations 1973
The Requirement That Scientific Research Be in the Public Interest 1973
The Scope of Scientific Activity Under Section 501(c)(3) 1976
Scientific Research and the Unrelated Business Income Tax 1977
Governmental Research 1977
Research Activities of 501(c)(3) Colleges, Universities, Hospitals, and Organizations Engaged Primarily in Carrying on Fundamental Research 1977
VII Other Exempt Purposes: Prevention of Cruelty to Children or Animals, Literary, and Testing for the Public Safety 1977
Prevention of Cruelty to Children 1977
Prevention of Cruelty to Animals 1978
Literary Purposes 1978
Testing for Public Safety 1979
VIII Business Activities of 501(c)(3) Organizations 1980
Historical Background of the Rules Relating to Business Activity 1980
Concept of Unrelated Business Activity 1981
Denial of Exemption to Feeder Organizations 1985
Cooperative Service Organizations 1985
Footnotes 1988
Appendix: *The Federal Income Tax Exemption of Charitable Organizations: Its History and Underlying Policy* Chauncey Belknap 2025

Tax Policy Relating to Environmental Activities and Public Interest Litigation *A.M. Wiggins, Jr.* and *Bert W. Hunt* (1975) 2045

Introduction 2045
I Distinction Between Section 501(c)(3) and Section 501(c(4) 2046
The Nature of the Distinction 2046
Tax Consequences of the Distinction 2046
Impact on Environmental Activities 2047
II Activities Traditionally Recognized as Charitable or Educational 2047
Federal Policy Toward Conservation of Natural Resources 2047
Traditional Private Philanthropy 2048
III Activities of More Recent Concern or Controversial Nature 2050
Federal Environmental Policy 2050
Pollution Control and Abatement 2051
Basic Policy Issues 2051
Noncharitable Tax Incentives 2052

Page

- Charitable, Educational, and Scientific Activities (Other than Litigation) 2052
- Acquisition of Public Land 2053
  - Role of Private Organizations 2053
  - The Effect of Uncertainties 2054
  - Tax Status of Gains on Resale 2054
  - Tax Status of Income From Excess Land and Commercial Property 2055
  - Tax Status of Consulting Fees 2055
  - Effect of Charitable Activity on Market Prices 2056
- Charitable Contributions Deductions for Gifts of Scenic Easements 2056
  - Meaning of "Scenic Easement" 2056
    - The holder of the benefit 2056
    - The nature of the benefit 2056
    - Alternative legal forms 2057
  - Deductibility of Gifts of Scenic Easements 2057
  - Issues and Problems With Respect to Scenic Easements 2058
    - Should contributions of scenic easements be deductible? 2059
    - Distinctions between income tax deductions and gift and estate tax deductions 2060
    - Administrative problems 2061

IV Public Interest Litigation 2061

- Environmental Litigation Illustrated – the TAPS Case 2062
  - Background 2062
  - Litigation 2063
  - Executive Action 2063
  - Return to the Courts 2064
  - Congressional Resolution 2064
  - Legal Fees 2066
  - Observations 2067
- Examination of Public Interest Litigation 2068
  - The Problem of Identifying Charitable Litigation 2069
  - The Primary Policy Issue 2069
  - Criteria and Rules for Identifying Public Interest Litigation 2070
    - The IRS guidelines 2070
    - "Public interest" defined 2071
    - Proposed criteria and rules 2072
    - Who is to select public interest litigation? 2075
    - Relief to be sought 2077
  - Collection of Attorneys' Fees 2078
    - Fundamental Considerations 2078
    - Analogy to schools and hospitals 2082

Page

From whom would fees be collected? 2082
Determining the amounts of legal fees 2085
Recent IRS action and summary of policy questions 2085
V Discussion Draft of Criteria and Rules for Determining Public Interest Litigation 2089
Three Basic Criteria 2089
Applicable Rules 2089
Application of the Criteria 2089
Organizational Rules 2090
Operational Rules 2090
Attorneys' Fees 2091
Footnotes 2093

An Analysis of the Federal Tax Distinctions Between Public and Private Charitable Organizations *Laurens Williams* and *Donald V. Moorehead* (1975). 2099

Introduction 2099
I Development of Statutory Distinctions Between Public and Private Charitable Organizations 2100
Early Revenue Acts 2100
Revenue Act of 1950 2101
Internal Revenue Code of 1954 2102
Revenue Act of 1964 2103
The Tax Reform Act of 1969 2103
Antecedent Studies 2104
The Walsh Commission 2104
Cox Committee 2104
Reece Committee 2105
Patman Investigations 2105
Treasury Department Report on Private Foundations 2105
Peterson Commission 2107
An Overview of the 1969 Changes 2108
Charitable contributions 2108
Tax on investment income 2108
Self-dealing 2108
Minimum distribution requirements 2109
Excess business holdings 2109
Speculative investments 2109
Taxable expenditures 2109
Annual reports 2109
Scope of Private Foundation Definition 2110
II Analysis of the Reasons Prompting Current Statutory Distinctions Between Public and Private Charities 2111

Page
Deductibility of Contributions 2112
Tax on Investment Income 2113
Annual Public Reports 2115
Restrictions on Financial Practices and Programs 2116
  Restrictions on Self-Dealing 2116
  Minimum Distribution Requirements 2117
  Excess Business Holdings 2118
  Restrictions on Speculative Investments 2118
  Restrictions on Program Activities 2119
    Attempts to Influence Legislation 2119
    Influencing Elections 2120
    Restriction on Grants to Individuals and to Other Private Charities 2120
III Findings and Recommendations 2120
General Comments 2120
Areas of Questionable Distinctions 2121
Areas in Which Distinction May Be Appropriate 2122
  Possible Bases for Distinction 2122
    Type of organization 2122
    Public support 2123
    Functional test 2123
    Public control 2123
  Application to Specific Areas 2123
IV Conclusions 2124
Footnotes 2124

The Charitable Deduction Under Section 170 of the Internal Revenue Code *John A. Wallace* and *Robert W. Fisher* (1975) 2131

Introduction 2131
Original Justification for the Charitable Deduction 2131
Overview of the Statutory Scheme 2132
I Definition of Charitable Contribution 2133
Statutory Definition 2133
  Governmental Units 2133
  Charitable Corporations, Trusts, Community Chests 2134
  Posts or Organizations of War Veterans 2134
  Domestic Fraternal Societies, Orders, or Associations Operated Under the Lodge System 2134
  Cemetery Companies 2135
  Amounts Paid to Maintain Certain Students as Members of Taxpayer's Household 2135
Publication 78 2135
II Partial and Split-Interest Transfers 2136
Remainder Interests in Trust 2136
Income Interests in Trust 2138
Transfers of Partial Interests 2139

Page

III Amount of Contributions: Appreciated Property Rules 2140
Development of Reduction Rules 2140
Contributions of Ordinary Income Property 2141
Contributions of Unrelated Use Tangible Personal Property 2142
Other Problems 2143
IV Amount of Deduction: Percentage Limitations 2145
The Limitations in General 2145
Capital Gain Property Limitation 2146
Interrelationship of Limitations 2148
Carryover Rules 2149
V Bargain Sales 2151
Interaction with Percentage Limitations 2152
Exchanges 2152
Interaction with Reduction Rules 2153
Charitable Transfers in Exchange for Annuities 2153
Charitable Transfer Subject to or in Exchange for the Donee's Assumption of Debt 2154
VI Conclusion 2154
Footnotes 2155

Personal Deductions in an Ideal Income Tax *William D. Andrews* (Harvard Law Review reprint, 1972) 2163

I An Ideal Personal Income Tax 2167
The Meaning of Personal Income 2167
Money Income 2168
Income as Compensation for Services or Use of Capital 2168
Income as Accretion 2169
Income as Consumption Plus Accumulation 2169
The Purpose of a Personal Income Tax 2172
The Strategy of Personal Income Taxation 2173
The Role of Personal Deductions 2175
II The Medical Expense Deduction 2176
The Case for Excluding Medical Services from Personal Consumption as a Component of Taxable Income 2177
A Closer Look at Distribution Implications 2179
Vertical Equity 2179
Horizontal Equity at Low Income Levels 2180
Allocation Effects 2181
III The Charitable Contribution Deduction 2183
Alms for the Poor 2184
The Problem of Ordinary Gifts 2185
The Problem of Imputed Income 2187
Consumption as Power 2188
The Pleasure of Giving 2189

Page
Philanthropy More Broadly Defined 2189
Taxing the Recipient on the Value of Services Provided by Charities 2190
Taxation of Charitable Contributions as a Proxy for Taxing Benefits 2192
Taxing the Contributor in his Own Right 2193
Neutrality with Respect to Expenditure Choices 2196
Philanthropy from a Community Perspective 2196
Charity by the Idle Rich 2198
Contributions Out of Investment Income 2198
Unrealized Capital Appreciation 2199
Realized Capital Gains 2199
Contributions Out of Accumulated Wealth Generally 2200
Conclusion 2200
IV Summary and Implications 2200
Uses and Sources of Income 2201
Business and Household Activities 2203
Consumption and Accumulation 2204
Footnotes 2206

Explanation and Analysis of Split-Interest Gifts to Charity *Theodore A. Kurz* and *Barbara P. Robinson* (1974) 2221

Introduction 2221
I Charitable Remainder Trusts in General 2222
Charitable Remainder Annuity Trusts 2224
Charitable Remainder Unitrusts 2224
II Charitable Gift Annuities 2225
III Pooled Income Funds 2228
IV Charitable Lead Trusts 2229
V Remainder Interests in Personal Residences or Farms 2231
VI An Undivided Portion of the Donor's Entire Interest in Property 2232
VII Charitable Gifts of Life Insurance 2233
VIII Valuation of Split-Interest Gifts to Charity 2234
The Effects of Revising the Six Percent Tables 2235
Why Different Types of Split-Interest Gifts of Money Can Produce Different Sized Deductions 2235
IX Issues Relating to Split-Interest Gifts to Charity 2237
The Propriety of the Tax Treatment of Split-Interest Gifts to Charity 2237
The Valuation of Split-Interest Gifts to Charity 2238
Six Percent Tables 2238
Differences in Valuation for Various Types of Split-Interest Gifts 2239

Page

The Annual Five Percent Minimum Noncharitable Payout for Charitable Remainder Trusts 2240
Inconsistencies Among Various Types of Split-Interest Gifts 2240
Investment in Tax-Exempt Securities 2240
Gift Annuities Versus Charitable Remainder Annuity Trusts 2241
General Thrust and Effect of the 1969 Tax Reform Act on Split-Interest Trusts; The Need for Transitional Relief 2241
Footnotes 2244

Part II

Appreciated Property Deduction

Legal Aspects of Charitable Contributions of Appreciated Property to Public Charities *Harry K. Mansfield* and *Ronald L. Groves* (1975) 2251

Introduction 2251
I The Present Rules and Their Evolution 2251
Pre-1969 History 2251
Tax Reform Act of 1969 2252
In General 2252
Contributions of "Ordinary Income Property" 2252
Enactment of section 170(e)(1)(A) 2252
Scope of section 170(e)(1)(A) 2253
Special categories of ordinary income property 2254
Contributions of "Capital Gain Property" 2255
Section 170(e)(1)(B) 2255
"Unrelated Use" 2256
Gifts to foundations 2257
Bargain Sales 2257
In general 2257
Interaction of sections 1011(b) and 170(e)(1) 2258
Special problems 2258
The Thirty Percent Limitation 2259
II Some Legislative Alternatives to the Treatment of Appreciated Property 2260
Retention of Existing Basic Framework with Specific Modifications 2260
In General 2260
Possible Areas of Modification 2261
Return to Fair Market Value Standard 2261
Limitation of the Deduction to Cost in the Case of All Appreciated Property 2261
Reduction of the Deductible Amount by a Uniform Percentage of Appreciation in the Case of All Appreciated Property 2262

Page

Return to Fair Market Value Standard but with Tax on Amount of Appreciation as if Property Sold and Proceeds Contributed 2263
Inclusion of Appreciation in the Minimum Tax in Year of Contribution 2263
Retention of Present Reduction Rules with Increase in Holding Period for Long-Term Capital Gain Treatment 2263
III Theoretical and Policy Considerations 2264
Comparative Treatment of Transfers of Appreciated Property 2264
Alternatives for the Donor 2265
Gift of Cash 2265
Gift of Net Proceeds Following a Sale 2265
Retention of Property or Proceeds of Sale 2265
Other Gratuitous Transfers 2266
Summary 2266
Views of Some Tax Professors 2266
The Effect of the Deduction as an Inducement 2267
Footnotes 2268

A Pro-Charity Substitute for the Present Law Tax Treatment of Appreciated Property Contributed to Charity *Gerard M. Brannon* (1975) 2273

Part III

Volunteer Services

Treatment of Volunteer Services and Related Expenses Under the Internal Revenue Code *Edmund C. Bennett* (1976) 2287

I History of the Rule 2287
II The Distinction Between Property and Services 2288
Criteria to be Used in Making the Distinction 2289
Factors Limiting the Effectiveness of the Criteria 2291
III Availability of a Deduction for Expenditures 2291
The Rule in General 2291
Factors to be Considered 2293
The Effectiveness of the Deduction 2294
Footnotes 2294

Part IV

Estate and Gift Taxes

Estate Tax Deduction for Charitable Benefits: Proposed Limitations *John Holt Myers* (1975) 2299

Page
Introduction 2299
I History and Purposes of Estate Tax Deduction 2299
Importance of Bequests 2301
The Deduction as an Incentive to Charitable Bequests 2301
II Criticisms and Evaluation of Estate Tax Deduction 2302
Criticisms 2302
The Charitable Deduction and the Objectives of the Estate Tax Statute 2304
The Charitable Deduction as an Incentive to Support of Charitable Organizations 2304
Effect of Changes in the Estate Tax Deduction 2305
III Conclusions 2306
Appendix A 2307
Appendix B: Foundation Grant Study 2308
Appendix C: Summary of Foundation Center Study 2311
Appendix D 2313
Footnotes 2317

Dimensions of Charitable Giving Reported on Federal Estate, Gift, and Fiduciary Tax Returns *Emil M. Sunley, Jr.* (1975) 2319

Summary of Data 2319
I Estate Tax Returns 2320
Time Series Data 2321
Charitable Bequests by Size of Total Estate 2321
Charitable Bequests in Excess of Designated Percentages of Economic Estates 2321
Charitable Bequests by Type of Recipient 2327
II Gift Tax Returns 2327
Time Series Data 2328
Charitable Gifts by Size of Total Gifts Before Splitting 2328
III Fiduciary Income Tax Returns 2328
Footnotes 2336

Death, Taxes, and Charitable Bequests: A Survey of Issues and Options *Richard E. Wagner* (1974) 2337

Introduction 2337
I Is the Charitable Deduction a Form of Governmental Subsidy? 2338
The Charitable Deduction as a Tax Expenditure 2338
Policy Alternatives to the Charitable Deduction 2339
A Ceiling on Deductibility 2339
A Tax Credit for Charitable Bequests 2340
A Matching Grant to Charitable Organizations 2341
In Support of the Charitable Deduction 2342

Page

II Constructive Realization of Capital Gains Upon Death 2344
III The State and the Support of Private Philanthropy 2346
IV Concluding Summary 2349
Footnotes 2350

Proposed Limitations on the Estate Tax Deduction for Charitable Transfers *David Westfall* (1974) 2353

Introduction 2353
I Performance of Governmental Functions 2353
II Performance of Public Functions that Government Would Not Undertake 2354
III Fairness to Transferors (or Their Beneficiaries) 2355
IV Incentive Effects 2355
Footnotes 2358

Part V

Alternatives to Tax Incentives

Alternative Approaches to Encouraging Philanthropic Activities *Gerard M. Brannon and James Strnad* (1975) 2361

Introduction 2361
I A Classification of Alternative Approaches to Encouraging Nonprofit Activities 2362
  Education 2363
  Medical Service Organizations 2363
  Religious Organizations 2363
  Welfare Activities 2364
  Artistic Activities 2365
  Basic Research Activities 2366
II Evaluation of Noncontribution Alternatives 2366
  General 2366
  Education 2368
    Evidence of Overt Contributor Influences 2368
    Evidence of Covert Influences 2370
    Locality Effects 2372
    Alternatives to Contribution Subsidies 2373
  Medical Services Charities 2374
    Aspects of the Present System of Tax Deductible Contribution Funded Health Charities 2374
    Client Payment Subsidy Alternatives 2377
    Alternatives to Contribution Subsidies for Medical Research and Facilities 2378
  Welfare Activities 2378
    Relief to the Poor 2378

Page

Relief for Special Circumstances 2379
Disaster Relief 2380
Supplemental Military Programs 2380
Foreign Aid 2381
Arts 2381
Performing Arts 2381
The Plastic Arts 2381
III The Political Problem 2382
IV The Relative Costs of Alternative Arrangements to Subsidize Nonprofit Activities 2383
V In Lieu of a Conclusion 2385
Footnotes 2385

A Tax By Any Other Name: The Donor Directed Automatic Percentage Contribution Bonus, A Budget Alternative for Financing Governmental Support of Charity *David A. Good and Aaron Wildavsky* (1975) 2389

Introduction 2389
I Budget Alternatives 2391
II Proposals, Criteria, and Consequences 2394
Tax Write-off 2396
The Tax Credit 2399
Percentage Contribution Bonus 2400
Sliding Matching Grant 2405
III What Difference Does the Government Subsidy Make? A Sensitivity Analysis 2406
IV How Much of Which Problems Are We Prepared To Live With? A Criteria Analysis 2407
Perspectives: Donors, Charitables, Government 2409
Trade-Offs 2409
V Political Feasibility 2411
VI Testing the Percentage Contribution Bonus 2414
Footnotes 2415

Study of Federal Matching Grants for Charitable Contributions *Paul R. McDaniel* (1975) 2417

Summary 2417
I General Description of Matching Grant System 2418
Lifetime Gifts to Charity 2418
Testamentary Transfers to Charity 2419
II Analysis of Reasons For and Against Change From Tax Deduction System to Direct Matching Grant System 2420
Reasons for Change 2420
The Direct Matching Grant System Will Provide a More Equitable System of Expending Federal Funds for Charity 2420

Page

Equity from a tax viewpoint 2420
Equity from an expenditure program viewpoint 2421
Equity under the direct matching grant system 2425
The Direct Matching Grant System Will Enchance Pluralism and the Dispersion of Power Over Federal Funds 2429
The Direct Matching Grant System is More Effectively Targeted to Charitable Giving than the Income Tax Deduction 2430
The Direct Matching Grant System Provides a More Rational Framework Within Which to Determine the Amount of Federal Aid of Charity 2431
The Direct Matching Grant System Will Provide an Efficient Incentive to Donors to Give a Larger Percent of Their Income to Charity 2434
General comments on efficiency as a factor in evaluating the deduction and the matching grant system 2435
Economists' views of the efficiency of the income tax deduction 2435
Survey data 2442
Income elasticities 2443
Implications of studies for matching grant system 2444
Objections to Change and Responses Thereto 2445
The Direct Matching Grant Program Contains Its Own Equity Problems 2445
The wealthy control too much of the federal funds ... 2445
The notch effect 2447
The Use of a Ceiling on the Matching Grant System Reduces the Effectiveness of the Proposal as an Incentive 2448
The Proposed Direct Matching Grant System Will Involve Too Much Federal Control Over Charitable Organizations . . 2449
Donors Will Reduce Their Giving to Charity Because of Repeal of the Deduction 2449
Some Types of Charitable Institutions Will Suffer Reductions in Funds Received Relative to Other Kinds of Charitable Institutions 2450
The Direct Matching Grant System Creates Too Many Administrative Problems To Be Feasible 2450
The Proposed Direct Matching System Is Unconstitutional Because Direct Grants Would Be Made to Religious Organizations 2450

Page
III Effects of Change On Donors 2450
Effect of Repeal of Deduction Alone on Private Giving 2450
General Effect of Repeal of Deduction Coupled With Simultaneous Institution of Matching Grant System 2451
Estimates of Donor Responses Under Direct Matching Grant System 2453
Progressive Matching Grant Schedule 2454
Flat Matching Grant Schedule 2458
Comparison of Progressive Matching Grant and Flat Matching Grant 2458
Special Problem of Appreciated Property 2460
Conclusions as to Effect of Change on Donors 2462
IV Effects of Change On Donees 2462
Aggregate Effects on Charitable Organizations 2462
Effects on Particular Types of Charitable Organizations 2463
General 2463
Progressive Matching Grant 2467
Flat Matching Grant 2471
Comparison of Progressive Matching Grant and Flat Matching Grant 2471
V Administration of Matching Grant System 2472
Definitional Problems 2472
Progressive Matching Grant Method 2472
Flat Matching Grant Method 2474
Bunched Contributions: Averaging Problems 2475
Reporting of Donations 2477
Progressive Matching Grant Method 2477
Flat Matching Grant Method 2478
Disbursement of Funds 2478
Audit 2479
Compliance 2480
Transition Rules 2480
Treatment of Tax Deduction Carryovers 2480
Gradual Implementation of Matching Grant System 2481
VI A Matching Grant In Lieu Of Estate and Gift Tax Deductions For Contributions To Charity 2483
Introduction 2483
History and Present Structure of the Estate and Gift Tax Provisions 2483
The Function of the Charitable Deduction in the Estate and Gift Tax System 2484
Reasons For and Against Changes in the Present System 2485
Tax Equity 2485
Equity as an Expenditure Program 2485
Rationality of Appropriations Process 2487

Page

Efficiency of the Estate Tax Deduction for Charitable Bequests 2487
Proposal For a Matching Grant System 2488
Progressive Matching Grant 2488
Flat Matching Grant 2489
Gift Tax Aspects 2489
Effects of Introduction of the Matching Grant Proposal 2489
Equity Aspects 2489
Impact on Donors and Donees 2490
Special Problems in the Estate and Gift Tax Matching Grant System 2491
Relative Incentive for Lifetime versus Death-Time Giving 2491
Treatment of Transfers Subject to Both the Gift and the Estate Tax 2491
VII Federal Financial Aid To Charity: Constitutional Issues 2492
Introduction 2492
Historical Background 2492
The Supreme Court's Tests in First Amendment Religion Cases 2494
Tax Expenditures versus Direct Expenditures: Are the Constitutional Tests the Same? 2496
Functional Equivalence 2496
Constitutional Arguments Based on the Function of the Charitable Deduction in the Federal Income Tax System . . . 2500
Traditional analysis of the charitable deduction as a tax expenditure or tax incentive 2500
Minority view of deduction 2502
Conclusion 2503
The Constitutional Status of Direct Federal Financial Aid to Charitable Organizations, Including Religious Institutions 2503
Secular Legislative Purpose 2504
Primary Effect 2505
Excessive Entanglement With Religion 2508
Conclusion 2511
Appendix A: Note on Economic Theories of Sacrifice 2511
Appendix B: Note on Refundable Tax Credit 2513
Footnotes 2514

Page

Part VI

Property Tax

The Exemption of Religious, Educational, and Charitable Institutions from Property Taxation *L. Richard Gabler* and *John F. Shannon* (1975) 2535

Summary of Findings 2535
I Current Magnitudes and Trends 2536
  Summary of Previous Studies 2536
    Exempt Property in Selected States 2538
    Types of Exemptions for Religious, Educational, and Charitable Organizations 2542
II The Property Tax Exemption Debate 2542
  The Case for Exemptions 2542
  The Case Against Exemptions 2544
III Property Tax Exemptions: Intergovernmental Issues 2546
  Causes of Public Concern 2547
    Unpopularity of Property Tax 2548
    Height of the Property Tax 2551
    Increased Information 2554
IV Alternative State Options 2555
  Fiscal Alternatives 2555
    State Reimbursement Via In-Lieu Payments 2555
    State Authorization of Service Charges or In-Lieu Payments 2558
  Administrative Alternatives 2561
    Periodic or Annual Renewal 2561
    Local Option, With State Safeguards 2561
    Systematic Assessment and Publication of Findings 2562
Footnotes 2563
Bibliography 2564

VOLUME V

REGULATION

Part I

Regulation

Federal Oversight of Private Philanthropy *David Ginsburg, Lee R. Marks* and *Ronald P. Wertheim* (1975) 2575

Introduction 2575
I Overview and Summary of Recommendations 2576

Page

The Rationale for Government Oversight of Philanthropy 2576
Touchstones in Considering the Federal Oversight Role 2577
Summary of Recommendations 2578
II The Internal Revenue Service 2581
Statutory Framework 2581
Organization of Internal Revenue Service 2583
    General 2583
    Exempt Organizations 2584
Determinations of Exempt Status 2585
    Substantive Analysis 2586
    Initial Determinations 2592
        District Level 2592
        National Office: Exempt Organizations Branch, Technical 2595
        National Office: Office of the Chief Counsel 2598
    Revocation and Modification 2599
Advance Rulings on Proposed Transactions 2602
Compliance Functions 2604
    Organization of Compliance Activities 2604
        National Office Audit Division 2604
        Field Level 2606
    Incidence and Results of Exempt Organization Audits 2610
Independence and Objectivity 2613
    The Service's Record 2614
    Relevant Organizational Factors 2618
Coordination with State Authorities 2619
III Effect of the New Assistant Commissioner 2620
The Statutory Changes 2620
Effect on the Organizational Structure of Exempt Organization Administration 2622
    National Level 2622
    District and Regional Levels 2627
IV Philanthropy and the Civil Service Commission, Postal Service, and Agency for International Development 2631
Civil Service Commission 2631
    Eligibility Standards 2631
    Specific Requirements 2633
    Comments 2634
Postal Service 2635
    Reduced Rate Classes 2635
    Eligibility Standards 2636
    Eligibility Determination and Appeal Procedure 2637
Agency for International Development's Advisory Committee on Voluntary Foreign Aid 2638

Page

V Alternatives to the Internal Revenue Service as the Federal Oversight Agency 2640
  Proposals for a National Commission on Philanthropy 2640
  Evaluation 2642
VI Federal Regulation of Interstate Fund Raising 2644
  The Need for Federal Regulation 2644
  The Current Role of the Internal Revenue Service 2646
    Audits 2646
    Disqualification for Excessive Fund-Raising Costs 2646
    Public Information 2647
    Public Warnings 2647
  Pending Proposals for Federal Legislation 2648
    H.R. 1123 2648
    Truth in Contributions Bill 2649
    Some Comments on These Proposals 2652
  A Recommendation for Federal Regulation of Charitable Solicitations and Professional Fund Raisers 2653
    Location of the New Agency 2653
    Scope of the Disclosure Regulation 2654
    Nature of the Disclosure Regulation 2656
    What Should the Solicitation Statement Disclose 2656
    Accounting Standards 2656
    Anti-Fraud Provisions 2657
    Remedies and Enforcement 2658
    Registration of Professional Fund Raisers 2658
VII Judicial Remedies 2658
  Equity Enforcement Powers 2658
  Judicial Review of Adverse Status Determinations 2660
VIII Recommended Administrative Actions Within the Service 2661
  Dissemination of Data on Philanthropy 2661
    The Need for Data on Philanthropy 2661
    Categories of Data Needed 2662
    The Service's Role 2664
  Specific Administrative Actions 2664
    Status Determination and Rulings 2664
    Compliance Procedures and Practices 2665
    Personnel and Training 2665
    Public Informaton 2666
    Organizational Structure 2666
Appendix 2667
Footnotes 2668

Page

Judicial Remedies and Related Topics *Adam Yarmolinsky* and *Marion R. Fremont-Smith* (1975) 2697

I Improving the Judicial Remedies for Correcting Abuses and Determining Exempt Status 2698
II Private Benefit 2699
III Speculation 2701
IV Solicitation 2702
Uniform Accounting and Full Disclosure to Internal Revenue Service 2703
Availability of Information 2703
Federal Trade Commission 2703

The Status of State Regulation of Charitable Trusts, Foundations, and Solicitations *Office of the Ohio Attorney General* (1974) 2705

Introduction and Summary Findings 2705
Charitable Trusts and Foundations 2705
Charitable Solicitations 2707
Specific Recommendations 2708
Charitable Trusts and Foundations 2708
Charitable Solicitations 2709
I The Regulation of Charitable Trusts and Foundations 2710
The Common Law Power of the Attorney General with Respect to Charities 2710
Comparative Analysis of State Charitable Trust and Foundation Statutes 2712
The Office of the Attorney General 2726
Federal-State Relationships 2733
Reporting Requirements 2733
Publicity of Information Required from Certain Exempt Organizations and Certain Trusts Under IRC §6104(c) 2734
Abuses in the Administration of Charitable Trusts and Foundations 2736
The Feasibility of Uniform Charitable Trust and Foundation Legislation 2742
II The Regulation and Supervision of Charitable Solicitations 2752
Comparative Analysis of Charitable Solicitation Statutes and State Regulatory Agencies 2752
Analysis of The Model Solicitations Act and Proposed Revisions 2763
The Religious Organization Issue 2771
Appendix A: Selected Citations to Cases From Twenty-Three Jurisdictions Holding That the Attorney General Retains His Common Law Powers 2773

Page

Appendix B: Selected Citations to Cases From Twenty-Eight Jurisdictions Recognizing the Attorney General's Common Law Power to Enforce Charities 2774
Footnotes 2776

Self-Regulation in Private Philanthropy *Peter G. Meek* (1974) 2781

Introduction 2781
I Self-Regulation in Philanthropy: Overview and Selected Examples of Private Efforts with Regulatory Potential 2781
  Standard-Setting and Accreditation 2782
  Accreditation and the Role of the Federal Government 2783
  Standard-Setting to Guide and Encourage Public Support 2784
  Standard-Setting Within Single Organizations 2784
    The Advertising Council 2785
    The National Council on Philanthropy 2786
  Contributor Protection at the Community Level 2786
  Self-Regulation of Fund Raisers 2787
    National Society of Fund Raisers, Inc. 2787
    National Association for Hospital Development 2788
    American Association of Fund-Raising Council, Inc. 2788
II The Ad Hoc Committee (1959-1961) 2789
  Background 2789
  Action on Recommendation for a National Commission on Voluntary Health and Welfare Agencies 2792
  Action on Recommendation for Development of Uniform Accounting and Financing Reporting for Voluntary Agencies 2801
    Development and Publication of the Standards 2804
    Implementation of the Standards 2804
    Establishment of Ongoing Promotion and Supervision of Public Financial Reporting 2805
  Other Outcomes of the Report of the Ad Hoc Committee 2808
III The National Information Bureau 2809
IV Council of Better Business Bureaus: Philanthropic Advisory Department 2815
V United Way of America: Committee on National Agency Support 2817
  Committee on National Agency Support (CONAS) 2819
  National Budget and Consultation Committee (NBCC) 2821
  National Agency Review Board (NARB) 2823
  Standard-Setting by Local United Way Organizations 2824
VI The National Health Council: Membership Standards Program for Voluntary Health Organizations 2825
VII National Accreditation Council for Agencies Serving the Blind and Visually Handicapped 2829

Page

VIII Self-Regulation in Private Philanthropy Other Than Voluntary Health and Welfare Organizations 2832
Council on Foundations 2833
Joint Commission on Accreditation of Hospitals 2836
Self-Regulation in Higher Education 2838
American Association of Museums 2840
IX Issues in Self-Regulation for Consideration by the Commission on Private Philanthropy and Public Needs 2842
General Observations 2842
Issues for the Commission 2844
Appendix A: Better Business Bureau Standards for Charitable Solicitations 2846
Appendix B: National Budget and Consultation Committee Standards for National Voluntary Health, Welfare, and Recreation Agencies 2850
Appendix C: List of Organizations Described in Report 2854
Footnotes 2855

Preserving the Private Voluntary Sector: A Proposal for a Public Advisory Commission on Philanthropy *Adam Yarmolinsky* and *Marion R. Fremont-Smith* (1976) 2857

A Study of the Inadequacies of Present Financial Reporting by Philanthropic Organizations *Accounting Advisory Committee* (1974) . . 2869

Introduction 2869
Importance of Meaningful Financial Statements 2869
Authoritative Pronouncements 2869
Scope of Study 2870
Summary of Conclusions and Recommendations 2871
I Financial Reporting for Philanthropic Organizations 2872
Present Financial Statements are Difficult to Comprehend 2872
Present Accounting and Reporting Practices Are Subjective and Varied 2872
A Single, Uniform Set of Accounting Principles Should Be Adopted 2873
Recommended Accounting Principles and Reporting Concepts . . . 2876
Summary 2877
II Federal and State Regulatory Reporting 2883
Jurisdictions Have Different Reporting Requirements 2883
Usefulness of Financial Information in State Reports 2883
Usefulness of Financial Information in Federal Reports 2883
Recommended Standard Accounting Report (SAR) 2884
Advantages of the SAR 2884
Arguments Against the SAR 2888
Summary 2888

Page

The Fund-Raising Percent As a Quantitative Standard for Regulation of Public Charities, With Particular Emphasis on Voluntary Health and Welfare Organizations *Arthur Jack Grimes* (1975) 2889

Introduction 2889
I Findings and Recommendations 2891
II Measuring Productivity by a Fund-Raising Percentage 2895
Perspective 2895
Technical Influences 2897
Situation Influences 2897
Management Influences 2898
Identity Influences 2906
III Overview 2907
Appendix A: Sample of Health and Welfare Organizations Registered in New York State 2907
Appendix B: Choice of a Base for Comparing Fund-Raising Cost Percentages 2908
References 2912

Deductions for Lobbying by Public Charities: Constitutional Issues, Public Policy, and the Tax Reform Act of 1976 *Editor's Note* 2915

Legislative Activities of Charitable Organizations Other Than Private Foundations, With Addendum on Legislative Activities of Private Foundations *Pepper, Hamilton & Sheetz* 2917

I Summary of Present Law 2917
Section 501(c)(3) 2917
Regulations: Section 1.501(c)(3)-1 2917
Case Law 2918
Section 162(e) 2919
II Summaries of Arguments 2919
Major Arguments in Favor of Corrective Legislation 2920
Uncertainty of Present Law Should Be Corrected 2920
Charities Should Be Heard From by Governmental Bodies (Federal, State, and Local)—Both Volunteer Members and Staff 2920
Charities Should Be Allowed Basically the Same Rights As Trade Associations 2921
The Right to Communicate with Members is Critical to the Proper Functioning of Most Charities 2922
Major Arguments Against Corrective Liberalizing Legislation 2923
The Right to Lobby Should Be Restricted Rather than Increased 2923
Although it Might Well Be That the Law Should Be Clarified, the Clarification Should Not Result in Charities Being Allowed Additional Rights 2923

Page

There is No Need for Change: This Is One Area of the Law in Which Vagueness is an Attribute 2924
Major Arguments In Favor of Careful Restriction of Any Corrective Legislation 2924
The Right to Lobby Directly Should Be Severely Restricted (Though Allowed Under More Definite Rules Than at Present)–Otherwise There Would Be Available a Gigantic "Slush Fund" for Charitable Lobbying 2924
The Right to Deal With Members Should be Restricted, for Fear of "Grass Roots" Lobbying 2924
Any New Legislation Should be Carefully Structured to Impose Narrow Limits on "Grass Roots" Lobbying ... 2925
Public Charities That Lose Their Section 501(c)(3) Exemption Should Not Be Allowed to "Walk Away" With a Large Endowment Created With Tax Deductible Dollars . 2925
Areas of Apparent Agreement 2925
Areas of "Self Protection"–Analogy to Provision for Private Foundations 2925
Providing Technical Advice to Governmental Bodies 2925
Making Available Research Results 2925
Influencing Elections 2926
III Recent Legislative Proposals 2926
IV Conclusion 2928
V Recommendations: Legislative Activities of Charitable Organizations Other Than Private Foundations 2929
Appendix A: Text of H.R. 13720, H.R. 5095 and H.R. 12037 2931
Appendix B: Legislative Activities of Private Foundations 2940
Footnotes 2942

Limitations on Lobbying by Charitable Organizations *An Analysis Prepared for the Commission on Private Philanthropy and Public Needs* (1977) 2945

I Background: Recent Legislative and Litigating Activity 2945
II The Statutory Framework 2946
III No Preference For Business Lobbying in Present Law 2948
IV Constitutionality: The Doctrine of Unconstitutional Conditions 2949
V Constitutionality: Equal Protection 2953
VI Constitutionality: Vagueness 2956
VII Constitutional Questions Raised by Allowing Deductions for Personal-Choice Lobbying 2959
VIII Public Policy Issues 2962
Footnotes 2965

Part II

Foreign Practices

Overview of Governmental Support and Financial Regulation of Philanthropic Organizations in Selected Nations *Arthur Andersen & Co.* (1975) 2975

Introduction 2975
I Australia 2977
Scope of Activities of Private Philanthropic Organizations 2977
Tax Incentives 2977
Matching Grant Programs 2977
Financing of Charities 2978
Taxation of Charitable Organizations 2978
Administrative and Governmental Control 2978
Special Rules Applicable to Religious Groups 2979
II Canada 2979
Scope of Activities of Private Philanthropic Organizations 2979
Tax Incentives 2979
Matching Grant Programs 2980
Financing of Charities 2980
Taxation of Charitable Organizations 2980
Administrative and Governmental Control 2980
Special Rules Applicable to Religious Groups 2981
III England 2981
Scope of Activities of Private Philanthropic Organizations 2981
Tax Incentives 2981
Matching Grant Programs 2982
Financing of Charities 2982
Taxation of Charitable Organizations 2982
Administrative and Governmental Control 2983
Special Rules Applicable to Religious Groups 2983
IV France 2984
Scope of Activities of Private Philanthropic Organizations 2984
Tax Incentives 2984
Matching Grant Programs 2984
Financing of Charities 2984
Taxation of Charitable Organizations . . . . . . 298[illegible]
Administrative and Governmental Control 2985
Special Rules Applicable to Religious Groups 2985
V West Germany 2985
Scope of Activities of Private Philanthropic Organizations 2985
Tax Incentives 2986
Matching Grant Programs 2986
Financing of Charities 2986

Page

Taxation of Charitable Organizations 2987
Administrative and Governmental Control 2987
Special Rules Applicable to Religious Groups 2987
VI Italy 2988
Scope of Activities of Private Philanthropic Organizations 2988
Tax Incentives 2988
Matching Grant Programs 2988
Financing of Charities 2989
Taxation of Charitable Organizations 2989
Administrative and Governmental Control 2989
Special Rules Applicable to Religious Groups 2989
VII Japan 2990
Scope of Activities of Private Philanthropic Organizations 2990
Tax Incentives 2990
Matching Grant Programs 2990
Financing of Charities Organizations 2990
Taxation of Charitable Organizations 2991
Administrative and Governmental Control 2991
Special Rules Applicable to Religious Groups 2991
VIII Sweden 2992
Scope of Activities of Private Philanthropic Organizations 2992
Tax Incentives 2992
Matching Grant Programs 2992
Financing of Charities 2992
Taxation of Charitable Organizations 2993
Administrative and Governmental Control 2993
Special Rules Applicable to Religious Groups 2993

Taxation and Philanthropy in Canada *R. M. Bird* and *M. W. Bucovetsky* (1975) 2995

Introduction 2995
I The Dimensions of Private Philanthropy in Canada 2996
Individual Donations 2997
Corporate Donations 2999
Charitable Bequests 3000
Foundations 3001
II Tax Measures Explicitly Related to Philanthropy 3004
The Charitable Deduction 3004
Tax Treatment of Gifts of Appreciated Property 3009
The Exemption of Charitable Bequests 3012
Attitudes Towards Philanthropy 3013
III Capital Gains Taxes and Death Taxes 3015
The Debate on Capital Gains 3015
Death Taxes: A Casualty of Tax Reform 3017
The Case of Ontario 3022

Page

IV The Implementation of Deemed Realization 3025
  Quantitative Aspects of the Capital Gains Tax 3028
V Summary and Conclusion 3031
Footnotes 3034

The System for Regulation and Assistance of Charity in England and Wales, With Recommendations on the Establishment of a National Commission on Philanthropy in the United States *Donald R. Spuehler* (1975) 3045

Introduction 3045
  The 1972 Ditchley Conference 3045
  A Summary Description of English Practice and Assistance of Charities 3046
I The Charity Commission Under the Charities Act of 1960 3049
  General Structure 3049
  Registration 3050
    Registration of Existing Charities 3050
    Registration of New Charities 3051
  Accounts 3054
  The Official Custodian for Charities 3055
  The Consents Division 3057
  Local Review 3058
  General Supervision and Assistance 3060
    General Functions 3060
    Aid in Interaction with Government–The Almshouse Example 3062
    Modernization–Outmoded Purposes 3064
    Aid to Charities–Investment Policies 3065
    General Aid, Assistance, and Admonition of Charity 3066
  Summary 3067
II Tax Treatment of Charities and Their Donors 3067
  General Tax Principles 3067
  Taxation of Charities 3068
    Exempt and Unrelated Income 3068
    Denial of Income Tax Relief 3069
    The Private Settlement Trust–The Private Foundation Emerging in Britain 3071
    Effectiveness of Inland Revenue's Surveillance of Charity 3071
  Tax Treatment of Donors 3072
    Estate Duty 3072
    Capital Gains Tax 3072
    Gift Tax 3073
    The General Income Tax Rule–No Deduction for Charitable Gifts 3073
    The Deed of Covenant 3073

Page

III The Charities Aid Fund—A Unique Institutional Approach to Problems of Charities and Donors 3076
IV British Attitudes Toward the Charitable System 3078
V The Fruits of British Experience for the United States—A United States Charity Commission? 3080
Proposed Functions of a National Commission on Philanthropy .. 3080
In Search of a Function for a National Commission on Philanthropy—The Charity Commission Example 3082
Charity Commission Purposes Considered Undesirable for the United States 3083
Functions of the Charity Commission Considered Unnecessary for the U.S. 3083
Charity Commission Functions Possibly Useful to the U.S. ... 3083
Recommendations for a National Commission 3086
Footnotes 3087

Part I

Regulation

FEDERAL OVERSIGHT OF PRIVATE PHILANTHROPY

David Ginsburg,[†] Lee R. Marks[†] and Ronald P. Wertheim[†]

Introduction

American philanthropy disposes of more than $25 billion annually. It generates countless hours of volunteer manpower. It encompasses all religious activity. Historically it has assumed major responsibilities in areas such as education, health, the performing arts, poverty, and medical research. Professional fund raising is big business. Nevertheless, little thought has been given to the role of the federal government in regulating and assisting philanthropy,[1] or in regulating interstate charitable solicitations. As with many other private activities, the role of the federal government has evolved from the underlying premises of laissez faire and the efficacy of action by the states.

With the adoption of the first federal income tax law in 1894, it became necessary to specify what organizations would be exempt from the tax.[2] The tax laws having provided the original nexus between the federal government and philanthropy, the Internal Revenue Codes has become – more by accretion that by design – the principal vehicle for federal oversight of philanthropy.

It is against this background that the Commission on Private Philanthropy and Public Needs commissioned this study of the present relationships between the federal government and private philanthropy and what changes, if any, might be made. The study is especially timely because we have now had five years of experience with the Tax Reform Act of 1969; the federal government is now giving consideration to federal legislation to regulate interstate charitable solicitations; legislation has recently been enacted to create within the Internal Revenue Service a new Assistant Commissioner for Employee Plans and Exempt Organizations; and proposals have been made to transfer responsibility for philanthropy from the Internal Revenue Service to a new agency.

Over 20 categories of organizations are exempt from federal income tax, but only one is considered here[3] organizations that are exempt under section 501(c)(3) of the Internal Revenue Code, which exempts from federal income taxation.

> Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

The distinguishing – and critical – characterisitc of 501(c)(3) organizations is that contributions to them are deductible by the donor, on the donor's income, estate or gift tax return, as charitable contributions.[4] This characteristic gives rise to the special opportunities to accumulate private wealth that these organizations enjoy, in recognition of special obligations attached to the use of that wealth.

The rationale for the special role of philanthropy in society, and for federal oversight of philanthropy, is dealt with in Chapter I. We also summarize our principal recommendations in Chapter I.

[†] Ginsburg, Feldman and Bress, Washington, DC.

Since the federal government's oversight of charitable organizations,[5] is exercised almost exclusively through administration of the Internal Revenue Code, a study of that oversight must begin with the Code and the Internal Revenue Service. In Chapter II, we examine how the Internal Revenue Service functions. We study the Service in some detail, in part to document how we have derived our conclusions and in part because it illustrates the issues that would have to be dealt with – of policy and administration – if a new agency were created to assume the Service's present responsibilities for charitable organizations.

In December of 1974 the Internal Revenue Code was amended to establish, within the Internal Revenue Service, an Office of Employee Plans and Exempt Organizations under an Assistant Commissioner. In Chapter III, we examine the likely impact of philanthropy of the new office and assistant Commissioner, and the reorganization of repsonsibilities within the Internal Revenue Service.

The federal government also bears on charitable organizations in other ways. The Civil Service Commission authorizes participation in annual solicitation campaigns among federal employees; the Postal Service grants special mailing privileges to certain charitable organizations; organizations registered with the Advisory Committee on Voluntary Foreign Aid are eligible for certain federal benefits. These activities we describe in Chapter IV.[6]

Chapter V considers alternatives – whether, for example, a new agency should be established to perform for charitable organizations the functions now entrusted to the Internal Revenue Service.

In Chapter VI, we consider whether there is a need for federal oversight, and if so what kind and by what agency, in an area that is not now regulated by the federal government: interstate charitable solicitations. Our recommendations in this regard appear in that Chapter.

Chapter VII contains our recommendations on enforcement powers for the Service and judicial review of adverse determinations of exempt status, both of which would require legislation. Our recommendations for administrative actions within the Service appear in Chapter VIII.

I

OVERVIEW AND SUMMARY OF RECOMMENDATIONS

The Rationale for Government Oversight of Philanthropy

Philanthropy has a special character: although designed to serve public ends, it is a private activity carried out with private funds.

The assets of private philanthropy are sometimes characterized as "public funds," the expenditure of which has been delegated to private persons by virture of the charitable deduction and tax exemption. We find this characterization troublesome and misleading.

First, the Internal Revenue Code contains numerous credits, deductions, exemptions, and so forth, designed to stimulate activities regarded as socially desirable. Insofar as it affects the private or public character of the funds, the deduction for charitable contributions is difficult to distinguish from other provisions of the Code. As a leading jurist has noted, "[I]f the tax exemption given to charitable foundations converts their giving into government action, I see no really tenable basis for distinguishing the tax deductions allowed individuals and corporations.[7]

Second, private philanthropy is an important part of this nation's historic commitment to the diffusion of power, to the belief that numerous sources of private and governmental authority stimulate experimentation, test ideas in competition with each other, and provide flexibility in meeting our needs. To regard philanthropic funds as public undermines this commitment. In his *Report of the President of the Carnegie Corporation, 1968,* Alan Pifer observed:

> Throughout our history we have believed in pluralism and have practiced it. We have recognized that the nation's public purposes are considerably more extensive in scope than its governmental purposes, and, through the aegis of the state, we have enabled a wide variety of private institutions, including foundations, to be chartered to accomplish certain public, though nongovernmental, purposes. We have also, through the aegis of the state, given tax exemption to these institutions to facilitate their work and have regarded this as being eminently in the public interest. Therefore, to attribute the public stake in the foundation to its tax-exempt status or to regard this status as a "privilege" is wholly erroneous. It is, in Professor Milton Katz's pithy phrase, "to mistake an effect for a cause."

Third, to credit the tax system with determining the character of charitable funds reinforces the tendency to attribute the public stake in philanthropy solely to its tax-exempt status. In fact, that stake is much broader.

As the volume and public importance of philanthropic activity has increased, the legitimate interest of government in that activity has also increased. At one time, the objects and concerns of philanthropy and government were largely separate. In this century they have increasingly coalesced as a result of changing concepts of the government's social responsibilities and of the proper goals of philanthropy. Philanthropy and government now share responsibility in areas such as health, social welfare, education, performing arts, minority rights, poverty programs, and environmental and consumer interests. Government's interest in how philanthropy conducts itself in these area has understandably, and inevitably, increased. Moreover, the economic magnitude of philanthropic activity, stimulated in part by higher federal income tax rates since World War II, has attracted the interest of government in the social and economic impact of such tax-free activity, and in the fundraising practices that contribute to its support.

Finally, for much the same reasons that led to increased federal regulation in other areas – an increasingly complex, interdependent society; large institutions whose activities have national impact; the potential for abuse in the absence of supervision; and the failure or inability of state governments to regulate effective – it has become apparent that in many cases the only practical source of supervision is the federal government.

Historically, the federal government's increasing interest in how philanthropy conducts itself found a convenient vehicle in the tax requirement that philanthropic organizations be "organized and operated exclusively"[8] for charitable purposes. This provided a nexus between the federal tax laws and philanthropy, and the Internal Revenue Service provided an administrative capability to implement new statutory controls. But the fact that the Internal Revenue Code became the statutory vehicle should not obscure the fact that many provisions concerning philanthropy have *regulatory* rather than *revenue collection* objectives. Thus, the tax on unrelated business income of exempt organizations was designed primarily to prevent unfair competition with business enterprises. Similarly, the Tax Reform Act of 1969 affecting private foundations were intended to regulate perceived abuses among donors and managers of private foundations.

Touchstones in Considering the Federal Oversight Role

Several experienced and thoughtful observers have called for a new federal agency or commission to regulate philanthropy and for the transfer to this agency of many functions presently performed by the Internal Revenue Service. It has been suggested, for example, that the determination of what constitutes charity should be made by such an agency rather than by the Service. Both in evaluating this alternative and in considering generally the desirable federal role in oversight of philanthropy, it is useful to identify at the outset certain touchstones against which both the Internal Revenue Service's performance and other proposals may be measured:

1. Federal oversight of philanthropy should be objective, nonpartisan, non-ideological. Recognition of charitable status is a license to operate – frequently in areas affecting free speech and expression – and should be granted or withheld without regard to political party. Not only must application of standards be objective, nonpartisan, and non-ideological, but it must be understood and perceived as such by the Congress, by charitable organizations, by the public, and by the regulatory agency itself. The government's role in this area should be characterized by legal and institutional self-restraint.

2. Philanthropy should not be overregulated. The flexibility, creativity, and initiative of private institutions are among the principal justifications for the special role of philanthropic organizations in our society and their tax-free status. Regulation should thus be designed to preserve and enhance the private character of charitable activity as well as to ensure that it serves public purposes. The government's primary role in regulating philanthropy should be procedurally oriented – the government should focus on seeing that procedures are followed to assure the integrity of philanthropy, without regulating the specific ends of objectives of philanthropic activity.

3. The regulation of 501(c)(3) organizations, other exempt organizations, and nonexempt taxpayers must be coordinated, in view of the interrelationship of Code provisions affecting 501(c)(3) organizations and other provisions of the Code.

4. The administrative magnitude of the oversight effort affects the nature of the structure. We now have some 230,000 active 501(c)(3) organizations – not including numerous churches or public charities with gross receipts normally below $5,000 per year, which have not been required to seek an exemption determination and have not done so.[9] About 1,000 IRS employees administer the exempt organization provisions of the Internal Revenue Code; many more devote some time to the effort. The administrative tasks of overseeing such a universe of charitable organizations could not be undertaken by a small, organizationally simple, federal oversight agency.

Summary of Recommendations

Our conclusions and recommendations from this study are presented in Chapter V through VIII. For conveniecne we provide here a summary of the principal recommendations, with cross-references to more detailed discussion on some points.

The Internal Revenue Service Should Continue to Supervise Charitable Organizations (pages 2640-44).

It has been suggested that a new commission be established to assume the present responsibilities of the Service for charitable organizations. We think it preferable to leave these responsibilities with the Service. The Service has a tradition of nonpartisanship and independence that seems especially important for philanthropy. The Service's adherence to this tradition, although not perfect, has been good (pages 2613-19); it is uncertain whether a new commission could establish a similar tradition. Some criticisms of the Service have merit: attitudes toward charitable organizations sometimes seem to be conditioned by the primary emphasis of the Service on collecting revenue; procedural delays are frequently troublesome; until recently, exempt organization matters have not had a high priority for assignment of the Service's ablest personnel. But the Service has been sensitive to changing concepts of philanthropy (pages 2594-98), and the caliber of personnel working on exempt organization matters has improved in recent years (at least in the Service's National Office). Legislation creating the Office of Employee Plans and Exempt Organizations, and an Assistant Commissioner to head the office, provides an opportunity for further progress. There are indications that this opportunity will be used for substantial improvements, although it remains uncertain whether the new office will have adequate funding (pages 2620-31). Proposals to establish a new commission should at least be held in abeyance until the performance of the new office can be evaluated.

Exempt Organizations Should Be Authorized by Statute to Appeal to the Tax Court for Judicial Review of Any Exemption Application That Is Not Granted Within a Reasonable Time (pages 2660-61).

Judicial review of Service decisions is generally available only when taxes are assessed. This works no unusual hardship on most taxpayers, but it creates a major problem for exempt organizations. Since the denial or revocation of tax exemption – or failure to act on an exemption application – are not assessments, these actions are not judicially reviewable, even though they may effectively destroy an exempt organization. Moreover, the lack of judicial review deprives the Service of a growing body of judicial precedents to guide it in deciding novel exemption issues. We therefore recommend legislation authorizing an exempt organization to appeal to the Tax Court if an exemption application is denied, if exempt status is revoked, or if the Service fails to act on an application within a reasonable time.

The Service, Directly or Through the Justice Department, Should Be Authorized to Obtain Equitable Remedies For Violations of Code Provisions Relating to Exempt Organizations (pages 2658-60).

The only sanction provided by the Internal Revenue Code for a violation of section 501(c)(3) is revocation of exempt status. The remedy is not only drastic, but frequently harms charitable beneficiaries without remedying the violation or affecting the persons responsible for it. Under Chapter 42 of the Code, penalty taxes provide remedies other than revocation for specified transgressions by private foundations only. Essentially, however, the Service lacks flexibility to fashion relief appropriate to the problem; such flexibility should be available in light of the Service's regulatory responsibilities. We recommend that the Service (directly or through the Justice Department) be authorized by statute to obtain equitable remedies in the federal courts for violations of the exempt organization provisions of the Code.

To further cooperation with the states, the authorizing legislation might require that if parallel state action is commenced, the federal equitable relief would be stayed until the state action was resolved and would thereafter have to be consistant with the outcome in the state courts, much as the Treasury Department proposed in 1969.

The Internal Revenue Service Should Undertake a Major Program of Collecting, Analyzing, and Publishing Statistical Data About Philanthropy (pages 2661-64).

Surprisingly little data are available about philanthropy: who provides charitable funds, who spends them, and what they are spent for. No government agency now collects, analyzes, and publishes such data; private efforts must rely on information provided voluntarily; such information is fragmentary and cannot be verified. The Service already has much of the data that should be analyzed and published; it has computer facilities, data collection procedures, and a statistical publications program. Additional funding and staffing would be required, but the Service could conduct such a program under its existing authority. We believe the need for information is critical and that the Service is best equipped to meet this need. (Suggested categories of data needed are set forth at pages 2661-64.)

A New Federal Agency Should Be Established, Within an Existing Department (such as Treasury, Justice or under the Federal Trade Commission) or as an Independent Agency, to Regulate Interstate Charitable Solicitations By Requiring Disclosure of Information and Prohibiting Fraudulent or Deceptive Practices (pages 2644-58).

Interstate charitable solicitations have become a big business, with potential for abuse. It is difficult to determine to what extent abuses occur, or to quantify the amounts involved, but there are at least some indications that abuses may be widespread: fund-raising expenditures sometimes consume as much as 80 percent of contributions received through direct mail solicitations; an incentive for false or misleading statements is created by the practice of compensating fund-raising promoters with a percentage of receipts; little information is conveniently available to the potential donor for evaluating solicitation statements. There seems to be a need for federal regulation; neither state regulation nor self-regulation can deal adequately with large interstate solicitations.

We believe the need to protect donors and retain their confidence in the integrity of philanthropy can be met by requiring disclosure of material information rather than by substantively regulating solicitations or arrangements between soliciting organizations and professional fund raisers. We recommend that a new agency be established for this purpose, either as a bureau or service within an existing Department (our preference) such as Treasury, Justice, or under the Federal Trade Commission, or as an independent regulatory agency.

Subject to carefully framed exemptions related to factors such as size, religious activities, and intramembership or essentially private solicitations, all interstate charitable solicitations would be required to include material information pertaining to the solicitation and to the program and finances of the solicitating organization. The proposed text of such solicitation statements would be submitted to the new agency for advance review, to be used unless the agency requires changes within a reasonably prompt time. The agency would receive annual reports containing financial statements of soliciting organizations and would have authority to prescribe uniform accounting standards, to conduct investigations, and to obtain injunctive and other equitable relief through the federal courts for material misstatements or fraudulent solicitation practices.

The Internal Revenue Service's Administration of Exempt Organizations Should Be Improved and Strengthened in Specific Respects (pages 2664-66).

Our major recommendations for improved Service procedures, under the existing legal framework, are the following:

- Public comments should be requested by the Service on novel questions of exemption qualification or major modifications of previous rulings that have wide impact, to permit the Service to supplement its own expertise with the views of interested persons;
- Training programs for the Service's exempt organization field personnel should be updated and improved, with participation by experts from outside the Service;
- The new Office of Employee Plans and Exempt Organizations should have its own planning and research staff, with a capacity and readiness also to commission and publish studies relating to philanthropy by experts from outside the Service;
- The Service should sponsor seminars and educational programs throughout the country to familiarize the interested public and professsionals with applicable legal requirements and procedures, and the status of current Service issues, relating to philanthropy;
- The Service's exempt organization audit program should not be concentrated so disproportionately on private foundations;
- The Interpretative Division of the Chief Counsel's Office should include an Exempt Organizations Branch, with increased staff at the review level.

II

THE INTERNAL REVENUE SERVICE

Statutory Framework

The responsibility of the Internal Revenue Service, acting under statutory powers delegated by the Secretary of the Treasury to the Commissioner of Internal Revenue, is to provide "administration and enforcement of the internal revenue laws."[10] The principal mission of the Service's 71,000 employees is to achieve "the highest possible degree of voluntary compliance with the tax laws."[11] For persons covered by all but about 70 of the Internal Revenue Code's more than 2,500 pages, compliance means the payment of taxes. Within an organizational structure designed to achieve this mission, the Service collected over $237 billion of tax revenues in fiscal 1973.

Within that same organizational structure, about 1,000 of the Service's employees administer the exempt organizations provisions (some 70 pages) of the Internal Revenue Code. The Service is organized to perform essentially the same functions for all taxpayers, including exempt organizations: it determines the status of the taxpayer, prescribes the form of returns, monitors compliance, issues regulations and rulings interpreting the Code's requirements, and collects taxes due. The basic difference is that in the exempt organizations area, compliance is established by showing freedom from tax liability. The Service has acknowledged that this difference creates an "ambivalence in our posture" which, for many years, gave to exempt organizations a "relatively low order of priority" in the Service's planning.[12]

The substantive provisions of the tax law affecting exempt organizations appear in about 20 sections of the Internal Revenue Code.

Section 170 specifies the charitable contributions that may be deducted for federal income tax purposes by individual and corporate givers. The ceiling on deductions for contributions to public charities (and to private operating foundations, nonoperating foundations that distribute all their income, and community foundations) is higher than that allowable for contributions to private foundations generally. Section 170's complex rules defining organizations to which contributions qualify for the higher deductibility ceiling become, by cross-reference in section 509, part of the definition of public charities. While section 170 relates directly to the taxes of donors rather than of exempt organizations, it has an important impact on exempt organizations both indirectly through its effect on donors and through its definitional role in distinguishing between public charities and the organizations to which the Code's private foundations rules apply.

Section 501, exempting certain organizations from tax, contains the definition of exempt organizations qualifying under section 501(c)(3) quoted above. This definition, in addition to enumerating the purposes for which such organizations must be organized and operated, also forbids "private inurement" from the organization's net earnings and restricts attempts by exempt organizations to influence legislation or participate in political campaigns.

Section 502 denies exemption to "feeder organizations." Section 511-515 tax the "unrelated business income" of exempt organizations. These provisions are designed to place exempt organizations in the same tax position as nonexempt businesses with respect to trade or business activities which, while generating income for the exempt organization, are not themselves "substantially related" to the organization's exempt purpose or function.

All of these provisions antedate the Tax Reform Act of 1969 and apply to all 501(c)(3) organizations. The 1969 provisions adopted a new and more restrictive regulatory regime for "private foundations," defined in section 509 as all 501(c)(3) organizations that do not qualify for public charity status either by meeting the tests of section 170 for maximum deductibility of donor's contributions or by meeting certain other tests of public support.

Under section 508, enacted in 1969, with limited exceptions no charitable organization is exempt from taxation unless it applies to the Internal Revenue Service for recognition of 501(c)(3) status, and those that do not expressly apply for public charity status will be treated as private foundations.[13] In order for a private foundation to receive 501(c)(3) exemption, its charter must contain restrictions prohibiting it from engaging in various activities prescribed by chapter 42 (sections 4940-4948) of the Code, enacted in 1969.

Chapter 42 of the Code, applying only to private foundations, imposes an excise tax on the net investment income of foundations (section 4940) and, in addition, taxes a variety of foundation activities found by Congress to be undesirable.

Section 4941 taxes acts of self-dealing between foundations and "disqualified persons" (defined in section 4946 to include foundation managers, substantial contributors and related persons, and government officials).

Section 4942 taxes foundations that fail to distribute a minimum level of income in a qualifying manner each year.

Section 4943 taxes foundations that fail to reduce their stock holdings in any single business corporation in a prescribed manner.

Section 4944 taxes investments of a foundation that jeopardize the carrying out of any of its exempt purposes.

A number of "taxable expenditures" are specified by section 4945, including any expenditure for a noncharitable purpose and any grant to another private foundation for which the granting foundation does not exercise prescribed "expenditure responsibility."

The excise taxes specified by sections 4944 and 4945 are imposed not only upon the foundation but also upon the responsible foundation managers personally; in the case of section 4941, the excise tax is imposed upon the self-dealer and upon the responsible foundation manager.

Recently the Service has acknowledged that in the exempt organizations area it fulfills a regulatory rather than tax-collecting role.[14] While troubled by the breadth of its responsibility in this area, in which the Service admits that "the tax collector has never been entirely comfortable,"[15] those within the Service who specialize in exempt organizations (especially at the National Office) take this responsibility seriously and attempt to meet it fairly. In doing so, these officials are somewhat handicapped by (a) cumbersome procedures which were designed generally to meet the needs of the tax-collecting branches of the Service; (b) inadequate authority in relation to other officials near the top of the Service's hierarchy; (c) the understandable emphasis of the Service on its role as tax collector rather than as overseer of a non-revenue-producing activity; and (d) the generally weaker qualifications and training of the Service's field staff as compared with the National Office staff.

Noticeable improvements have occurred in recent years. The creation of a new Assistant Commissioner for Employee Plans and Exempt Organizations provides the opportunity for still further improvement.

Organization of Internal Revenue Service

General

Since 1952 the Service has been organized along functional lines, with operations conducted in the field under a nationwide system of regional and district administrators receiving supervision from a National Office in Washington, D.C.[16] The field organization consists of 58 Internal Revenue districts, each headed by a district director who reports for administrative purposes to one of seven Regional Commissioners, who report in turn to the Deputy Commissioner. The National Office consists of the Office of the Commissioner, the Office of the Chief Counsel, and offices of Assistant Commissioners who provide functional supervision to the field organization in areas such as Compliance; Technical; Planning and Research; Accounts, Collections and Taxpayer Service; Administration; and Inspection.

The district and regional offices each have their own audit staffs, which are furnished functional guidance by the National Office's Audit Division under the Assistant Commissioner (Compliance). However, there is no technical staff in the field. Consequently, the field may not resolve technical questions as to what the Internal Revenue Code requires or permits unless the questions are specifically answered by the Code, by published Treasury Regulations, or by precedents published as Revenue Rulings. All such matters are referred by the District Directors to the National Office for "technical advice."

If a tax question relates to a transaction that has already been completed, and the answer can be provided by clearly established rules,[17] a District Director may decide the question by issuing a "determination letter." If a taxpayer formally requests advance assurance from the Service as to the tax effects of a proposed transaction, the Service's "ruling" letter will be issued by the National Office.[18]

Treasury Regulations, which interpret particular provisions of the Internal Revenue Code for general application, are prepared by the Office of Chief Counsel in consultation with the Assistant Commissioner (Technical and with the Treasury Department's Office of Tax Legislative Counsel under the Deputy Assistant

Secretary for Tax Policy (Tax Analysis). These regulations, issued under the Commissioner's statutory authority to "prescribe all needful rules and regulations for the enforcement" of the Code,[19] have the force of law (subject only to rare reversal by the courts if found to be inconsistent with the Code). Under the same authority, rulings on the tax consequences of specific types of transactions or activities are periodically published by the National Office as Revenue Rulings, which constitute precedents,[20] in contrast to the much larger number of unpublished "rulings" letters issued each year to particular taxpayers.

To inform the public of the Code's requirements, the Technical Publications and Services Division under the Assistant Commissioner (Technical) develops explanatory publications and forms as well as form letters and other materials for the use of Service personnel. Computer programs for processing returns are written and maintained by the Accounts and Data Processing Division under the Assistant Commissioner (Accounts, Collection and Taxpayer Service).

Judicial review of Service decisions is generally available only when taxes are assessed. Once any technical questions have been resolved administratively by the National Office, a deficiency notice for taxes due may be sent to the taxpayer by the District Director. Only then may the assessed taxpayer, whether an exempt organization or otherwise, obtain a judicial determination by contesting the assessment in the Tax Court or by paying the tax and suing for a refund.[21] For most taxpayers, this works no unusual hardship since the taxpayer seldom has a need for judicial determination before the tax has been assessed. For charitable organizations, the procedure is a major problem since a denial or revocation of tax exemption is effectively a death sentence. Not constituting an assessment of tax, the denial or revocation of exempt status is not judicially reviewable. See pages 2632-34 below for a discussion of this issue.

Exempt Organizations

The administrative structure for dealing with exempt organizations has been gradually engrafted onto the general framework described above. Periodic changes to keep pace with increasing responsibilities over the past 20 years have been made to accommodate the Service's overall structure with the least possible alteration in existing lines of authority. As a result, the system has grown in size and complexity "like Topsy," in Commissioner Alexander's words.[23] All exempt organizations are dealt with alike; no separate provision is made for, or special personnel assigned to, 501(c)(3) organizations.

Until 1954, all applications for recognition of exempt status were referred to Washington, no matter how routine. Initial review of such applications was conducted as recently as 1950 by a Grade 3 clerk in the Income Tax Division;[24] no audits of exempt organizations were conducted except upon receipt of a complaint. In 1954 District Directors received authority to issue determination letters in routine exemption qualification cases not presenting involved or questionable issues,[25] but another 15 years elapsed before any field units were established to specialize in exempt organization matters.

The Service's present organization in the exempt organizations area, established basically in 1969-1970, was shaped primarily to meet what was then regarded as the need for a more adequate audit program.[26] The Service had increased audits of exempt organizations from 2,000 in 1962 to 13,000 in 1966, but the number thereafter decreased steadily to a 1970 level of only 8,500 in all exempt categories.[27] Commissioner Thrower has since noted that a more adequate audit program during the years preceding the Tax Reform Act of 1969 might have produced information enabling the Service to appraise criticisms of foundations in perspective and thereby might have changed the congressional climate that led to the provisions concerning foundations.[28]

In 1969, Commissioner Thrower committed the Service to audit all large foundations at least once every two years and other private foundations every five years. The number of revenue agents and tax auditors assigned to exempt organizations matters was doubled and they were given special training;[29] all exempt organizations matters in the field were centralized under specialists in 16 "key districts." The key district specialists handle applications for recognition of exempt status, which continue to be filed with local District Directors but are assigned to a key district for review, as well as audits of exempt organizations within each key district area.

The key district specialists remain part of the audit staff; their training and functional supervision are provided by the Exempt Organization Examination Branch established in 1970 in the National Office's Audit Division under the Assistant Commissioner (Compliance).[30] But substantive questions not clearly covered by established precedents are referred by the key district to the Office of the Assistant Commissioner (Technical) in the National Office.

The Audit Division Exempt Organization Examination Branch also maintains and determines uses to be made of the computerized Exempt Organization Master File (EOMF), which is the Service's principal tool for storage and retrieval of data concerning exempt organizations. Data maintained in the EOMF are transcribed periodically from returns and forms filed with the Service by exempt organizations; computer programs for processing the returns and forms are written and maintained by the National Office's Accounts & Data Processing Division under the Assistant Commissioner (Accounts, Collection, and Taxpayer Service).

Special procedures for exempt organizations permit key District Directors (actually acting through key district specialists) to issue "determination letters" recognizing the exempt status of new organizations and classifying them as private foundations, operating foundations or public charities under section 501(c)(3). But applications that present novel questions must be referred to the National Office for a ruling, and any adverse determination by a District Director (including modification or revocation of exempt status) is subject to review and "technical advice" by the National Office.[31] Within the National Office, such rulings and technical advice are issued by the Exempt Organizations Branch of the Miscellaneous and Special Provisions Tax Division under the Assistant Commissioner (Technical). The 110 professional staff members of this branch, and a few individuals in the Office of the Chief Counsel (plus a few former members of the Technical staff serving in the Audit Division's Exempt Organization Examination Branch), comprise the Service's experts in substantive matters affecting exempt organizations.

The Service's functions with respect to exempt organizations thus include initial determinations and modifications or revocations of tax-exempt status; issuance of regulations, rulings and published Revenue Rulings; audits; gathering and publication of data; application of sanctions; and coordination with branches of the Service administering other provisions of the Internal Revenue Code and with other agencies of the Executive Branch, the Congress and state regulatory bodies.

We turn now to a closer examination of how the Service performs these functions, and to related questions of institutional outlook and professional objectivity. We then consider the potential impact on these matters of the legislative enactment creating a new Assistant Commissioner for Employee Plans and Exempt Organizations.

Determinations of Exempt Status

Most 501(c)(3) organizations must apply to the IRS for recognition of 501(c)(3) exempt status.[32] Even the excepted organizations must apply "in order to establish" with IRS their exemption from income tax;[33] generally, only organizations that have received an IRS "determination letter" or ruling recognizing 501(c)(3) status are listed in the Treasury Department's Cumulative List of Organizations to which contributions are assured deductibility under §170(c).[34] Moreover, without application to IRS for recognition of public-charity status, any 501(c)(3) organization except a church (or church affiliate) is subject to the Code's restrictions on private foundations.[35]

Thus, the Service's first significant function with respect to charitable organizations is determining whether the applicant qualifies under 501(c)(3), and, if so, whether it is to be treated as a private foundation or public charity.[36] The determination is made on the basis of the organization's application, subject to review whenever information developed during audit (or from other sources) suggests that modification or revocation of a previous determination may be warranted. In either case, the matter is first handled by audit personnel of the Service's field staff; the substantive experts of the National Office's Technical staff enter the picture only if the Service's field personnel find that a National Office ruling or technical advice is necessary or if the organization, protesting an adverse determination by Service field personnel, requests that the matter be referred to the National Office for technical advice.[37]

Substantive Analysis

The Service's procedures for determining applicants' qualifications for 501(c)(3) status do not exist in a substantive vacuum; they have been devised to implement a standard prescribed by Congress. To provide the context in which the Service's procedures must thus be considered, and some perspective on the Service's responsiveness to new charitable concepts, we first review briefly the substantive results achieved under the Service's procedures.

Without regard to the merits of any particular decision, the record of the Service's 501(c)(3) determinations rulings over the past several years provides a basis for analyzing the degree to which the Service appears to have been responsive to changing conceptions of what constitutes a "charitable" purpose. While the public record is largely limited to published Revenue Rulings, which address generalize factual situations without identifying any particular applicants for recognition, these rulings are followed as precedents by Service officials in all cases that fall within their terms and thus would seem a fair indication of the actual results achieved in the thousands of unpublished determinations letters and rulings issued to applicants each year.[38]

Statutory limits. Before considering the actual results of the Service's Revenue Rulings, it is important to observe the statutory limits within which the Service must act in determining whether newly developing types of charity qualify for exemption under (501)(c)(3). The standard prescribed by Congress in 501(c)(3) employs broad and inherently ambiguous terms: "Organized and operated exclusively for religious, charitable, scientific, . . . literary, or education purposes . . ." None of these terms is defined by the Code.

The Treasury's Regulations construe "charitable as a discrete term, embracing "an exempt purpose in itself," separate and distinct from the other exempt purposes enumerated in 501(c)(3).[39] Since Congress has never indicated any intent to adopt a novel or specialized tax concept of "charitable" purposes,[40] the Regulations also state that the term is used in its "generally accepted legal sense . . . as developed by judicial decisions."[41] The common law of charities, however, originating with the Statute of Charitable Uses in 1601 under Queen Elizabeth I, defines charitable purposes largely in terms of the other exempt purposes (religious, educational, and so forth) that are enumerated in 501(c)(3), plus the broad purposes of relief of poverty and distress, lessening the burdens of government, or promotion of social welfare, all of which purposes are modified by the notion of "broad public benefit."[42]

This vague and somewhat circular ambiguity is compounded by the lack of judicial case law on new typess of charities – a lack which, ironically, results largely from the absence of any opportunity for new organizations to obtain judicial review of Service determinations 501(c)(3) recognition.[43]

The ambiguity of the statutory standard results in uncertainty and delay for protracted consideration by the Service of the relatively small number of difficult or "cutting edge" cases each year.[44] It also accords to the Service a breadth of interpretative discretion that is relatively untrammeled in the absence of judicial review. Much of this delay might be avoided and discretion narrowed if Congress were to adopt more precise standards for 501(c)(3) qualification that would eliminate or at least reduce substantially the uncertainties created by the present statutory ambiguity. Indeed, legislation to define more precisely the requirements for charitable exemption is advocated by some observers who are critical of the Service's performance in this area, including a former IRS Chief Counsel.[45] However, even assuming that Congress could be induced to grasp this nettle (which it has avoided since 1894), it is by no means clear that the interests of philanthropy would be served by transferring to the halls of Congress the periodic struggles that would still ensue over charitable concepts that depart from the prescribed norms. With more precise statutory standards the Internal Revenue Service would very likely have even greater reluctance than at present to depart from established patterns, thus relegating proponents of "cutting edge" proposals to a quest for legislative remedies in the political arena – an arena in which the advocates of inaction have a powerful edge, and in which philanthropy could become embroiled in ideological controversy.

Proposals (see pages 2660-61 below) to provide applicants for exemption recognition with judicial review, in a proceeding before the Tax Court for declaratory judgment whenever a favorable determination has not been issued by the Service within nine months (or some other reasonable period), could improve present conditions substantially. Not only would judicial review provide a remedy against undue delay by the Service, but the Service would have available a growing body of judicial precedents. We believe that within limits established by judicial review, the criteria for exemption should remain sufficiently broad and flexible to permit philanthropy to experiment in addressing new social needs as they arise.[46]

Service rulings. Despite the relative lack of judicial case law on new types of charitable activity, the Service's concern for consistent guidelines and for reference to the common law of charities has produced, as one persistent tendency, the view that some basis must be found in judicial precedent for recognition of new "charitable" purposes or concepts.[47] At the same time, the Treasury's Regulations and the Service's Manual support a countervailing and perhaps equally persistent tendency to construe "charitable" purpose as embracing all those designed to produce "benefit to the community at large.[48] To a considerable extent the Service's response to new charitable concepts reflects the outcome of an inevitable tension between these tendencies.

An examination of Revenue Rulings issued over the past 10 years discloses a considerable number addressed to types of charitable activity that are, or were at the time, controversial or innovative. A summary of the rulings that seem pertinent in this respect is set forth below, with more detailed attention then given to the two exemption questions that attracted greatest public attention during this period – racially segregated private schools and public interest law firms.

Women's rights and abortion:

- Providing free counseling and referral services to women on methods of resolving unwanted pregnancies, including lawful abortion, qualifies for 501(c)(3) exemption as educational in "instructing the public on a subject useful to the individual and beneficial to the community." Rev. Rul. 73-569, I.R.B. 1973-51, 12.

- Investigating employment practices that discriminate against women, publishing guidelines for employers and handbooks on women's rights, and educating women about "common problems they face as women with respect to their soci-economic image in society," qualifies under 501(c)(3). Rev. Rul. 72-228, 1972-1 Cum. Bull. 148.

Subsidized professional services:

- Erecting a medical building and facilities for rental at lower than normal rates to a doctor, to attract a doctor to serve an isolated rural community, is not disqualified for 501(c)(3) exemption by the personal financial benefit thereby derived by the doctor. Rev. Rul. 73-313, I.R.B. 1973-30, 16.

- Subsidizing young lawyers for three years while they establish a practice, in which they provide free legal services to low-income clients but charge fees to others in an economically depressed community which has a shortage of available legal services, qualifies for 501(c)(3) exemption. Rev. Rul 72-559, 1972-2 Cum. Bull. 247.

- Public interest law firms conducting litigation "upon any subject of public interest as determined by the applicant" may qualify under 501(c)(3) if they present positions on behalf of the public at large, do not normally take cases in which the private financial interests at stake would warrant private legal representation, do not accept fees except in accordance with procedures approved by the Service, are responsible for policies and programs to a board representative of the firm's staff or litigators or by any non-501(c)(3) organization, and are not operated in a manner creating identification or confusion with any private law firm. Rev. Proc. 71-39, 1971-2 Cum. Bull. 575.

Vocation training and related business enterprises:

- Providing job training for unskilled residents of depressed communities qualifies for 501(c)(3) exemption where the manufacture and sale of commercial products is merely the means of accomplishing this purpose, the scale of the commercial operation is not larger than reasonably necessary for provision of such training, and income from the commercial operation is used to finance other community service 1973-11, 11.

- Providing a low-cost retail grocery outlet in a poverty area does *not* qualify "under the basic common law concept of charity" even if a portion of the store's earnings is allocated for on-the-job vocational training of the hard-core unemployed, where the purpose of providing such a store is an end in itself and the store is conducted on a scale larger than is reasonably necessary for its training program. Rev. Rul. 73-127, I.R.B. 1973-11, 10.

- Providing equity financing and loans to business enterprises in disadvantaged urban areas, where funds are not available from conventional commercial sources, qualifies under 501(c)(3) as lessening prejudice and discrimination, helping to relieve poverty and combatting community deterioration; the fact that individuals receiving such financial assistance in their business endeavors do not themselves qualify for charitable assistance does not detract from the program's charitable character, as they are merely the instruments by which the charitable purposes are sought to be accomplished. Rev. Rul. 74-587, 1974-2 Cum. Bull. 12.

Private racial discrimination:

- A private school that does not have a racially nondiscriminating policy as to students does *not* qualify for exemption, because a charitable purpose, educational or otherwise, may not be contrary to public policy. Rev. Rul. 71-447, 1971-2 Cum. Bull. 230.

- Providing free recreational facilities to community residents does *not* qualify under 501(c)(3) where the use of the facilities is restricted to less than the entire community on the basis of race. Rev. Rul. 67-325, 1967-2 Cum. Bull. 113.

Promoting minority rights and viewpoints:

- See Rev. Rul. 72-228 above (women's rights organizations).

- Investigating discrimination against minority groups in housing and public accommodations, publishing the results and providing speakers and discussion leaders on the subject matter of such investigations, and encouraging proprietors of discriminatory establishments and trade associations to comply with civil rights laws, without engaging in boycotts, reprisals or picketing, qualifies under 501(c)(3). Rev. Rul. 68-438, 1968-2, Cum. Bull. 209.

- Providing funds for legal defense of members of a religious sect from prosecutions for state law violations, in cases involving substantial constitutional issues of religious freedom, where the tenets of the sect forbid its members from defending themselves in court, qualifies under 501(c)(3) as "promoting social welfare by defending human and civil rights secured by law." Rev. Rul. 73-285, I.R.B. 1973-27, 11.

- Educating the public on the dangers of an extreme political doctrine does *not* qualify under 501(c)(3) where a substantial part of the activity is distributing or presenting materials that attack identified individuals and institutions without a sufficiently full and fair exposition of the pertinent facts to enable the public to form independent opinions or judgments. Rev. Rul. 68-263, 1968-1 Cum. Bull. 256.

Low-income and integrated housing:

- Building and renovating homes for sale to low-income families, and providing financial aid to such purchasers, qualifies under 501(c)(3) as relieving the poor and distressed; building and selling low-cost housing units on an open occupancy basis to both low-and moderate-income members of minority groups qualifies under 501(c)(3) as eliminating prejudice and discrimination and lessening neighborhood tensions; and rehabilitating an apartment house for rental to both low-and moderate-income families in an old and run-down residential area qualified under 501(c)(3) as combatting community deterioration. However, erecting housing for rental to moderate income families in an area suffering a shortage of such housing, because of the high cost of land, increased interest rates and growing population, does *not* qualify as a charitable purpose under 501(c)(3). Rev. Rul. 70-585, 1970-2 Cum. Bull. 115.

- Promoting racial integration in housing by educational programs and by assisting white families to obtain homes in integrated neighborhoods, making mortgage loans to such families at prevailing bank rates or purchasing and reselling homes to such families at no profit, qualifies under 501(c)(3). Rev. Rul. 68-655, 1968-2 Cum. Bull. 213.

- Conducting a model demonstration housing program for low-income or displaced families, by rehabilitating and selling or leasing homes to such families on a nonprofit basis, utilizing funds received from sale of interest-bearing obligations as well as from grants and contributions, qualifies under 501(c)(3). Rev. Rul. 68-17, 1968-1 Cum. Bull. 247.

Free schools and day care:

- Acting as a clearinghouse and course coordinator by bringing together instructors and interested students, with no regular curriculum, open enrollment and courses on subjects ranging from handicrafts to philosophy and economics, taught at various locations and without salary by anyone who considers himself qualifies to teach, qualified for 501(c)(3) exemption as advancing education. Rev. Rul. 71-413, 1971-2 Cum. Bull. 229.

- An educational day care center operated adjacent to the premises of an industrial company, for preschool children selected on the basis of need from among children of the company's employees, of parents employed in other nearby factories and of other parents recommended by antipoverty and welfare agencies, with medical assistance available from the company's staff, participation of parents during the working day and tour of the company for the children as parts of the program, qualifies under 501(c)(3) as advancing education; "any private benefits derived by the company or the parents of enrolled children is incidental to the public benefits resulting from the organization's operations." Rev. Rul. 70-533, 1970-2 Cum. Bull. 112.

Environment and pollution:

- Educating the public on environmental deterioration due to solid waste pollution and collecting materials for sale to commercial companies for recycling, with net income from such sales used to help finance the educational program, qualifies under 501(c)(3); the income derived from sale of the waste materials to recycling companies is "merely incidental" to accomplishing the exempt purpose. Rev. Rul. 72-560, 1972, Cum. Bull. 248.

The Service's treatment of the racial discrimination question in private schools illustrates the interaction between concern for judicial precedent and for broader concepts of the public interest. It could be argued that segregated private schools did not benefit the community as a whole, but it seemed harder to argue that racial discrimination prevented them from being "educational," an apparently independent criterion under 501(c)(3). Many persons, including no doubt many in the Service, thought that Congress should resolve such a far-reaching and controversial policy issue. But Congress did not, and the Service continued until 1970 to accord exempt status to segregated private schools because there was no court decision holding that such schools were not "charitable."[49] Litigation on the issue was commenced against the Service.[50] The impasse was broken when the highest Service officials concluded that a charity cannot be created for a purpose whose accomplishment "would tend to frustrate some well-settled public policy."[51] In formally articulating this conclusion, Revenue Ruling 71-447 relied in part on the comment of the *Restatement (Second) of Trusts* that, "A trust for a purpose the accomplishment of which is contrary to public policy, although not forbidden by law, is invalid," as did the federal court which reached the same conclusion in the *Green* case.[52]

The question how far the Service should go in requiring affirmative antidiscrimination steps by private charitable organizations has remained troublesome. In 1972 the Service required affirmative steps only by private schools that "have not clearly established" their racially nondiscriminatory policy as to students.[53] Not until February 1975 did the Service propose to require *all* private schools to show affirmative steps to establish a racially nondiscriminatory policy, effectively extend that policy to faculty and staff, and require maintenance of records showing the reasons for rejection of all applicants for admission, financial aid or employment.[54] Such requirements have not yet been applied by the Service to exempt organizations other than schools, although the trend of court decisions may in due course produce that result.[55] Nor has the Service yet adopted a similar policy with respect to sex discrimination, although there too the courrts may be leading the way.[56] The sheer administrative task of undertaking to police some 230,000 exempt organizations in these respects, and concern for imposing burdensome recordkeeping requirements on all such organizations to ease the Service's own administrative task, are clearly among the factors that have cause the Service to move slowing in this area. There is also concern to observe the distinction between assisting in the formulation of broad public policy, which the Service does not regard as its proper role, and implementing public policies that have been firmly and indisputably established elsewhere.

The question of public interest law firms was controversial and difficult for the Service both because there were no guidelines as to the permissible objects of the litigation to be conducted by such firms and because the firms frequently purport to act on behalf of majority interests rather than disadvantaged minorities. In early 1970 the Service undertook to study the question, meanwhile holding up numerous pending applications.[57] After several months the Service announced publicly its special study and cautioned that during the interim it was unable to provide assurance of the deductibility of contributions. A flurry of public and congressional protests ensued; among the suggestions and comments received by the Service were many from professional and public interest groups, including the Tax Section of the American Bar Association. Shortly thereafter the Service issued Revenue Procedure 71-39 (summarized at page 2588 above) setting forth guidelines under which public interest law firms would receive 501(c)(3) recognition.

Those guidelines, it can be observed, avoided any criteria that would require the Service to judge whether the applicant's proposed objectives were favored by the Congress or the public. In explaining the Service's conclusions, Commissioner Thrower stated, " . . . we should not have and we would not want the responsibility of making such a determination . . . [which] would exclude recognition of litigation on behalf of unpopular causes not having Congressional approval, even though thought by the proponents to be in the public interest.[58] The Commissioner also observed that, " . . . we received a number of submissions that seemed prepared to concede to us the role of arbiter of the public good . . . I do not believe that Congress wishes Internal Revenue to make such wholly subjective, ad hoc decisions."[59]

Discussion. In resolving these questions and the others summarized at pages 2587-90 above, it does not appear that the Service frustrated the recognition of innovative or controversial new charitable concepts. In some cases the Service has set conditions or drawn distinctions that may be more restrictive than proponents of the activity believe appropriate, for example, on receipt of fees by public interest law firms,[60] limitation of business enterprises associated with vocational training to a size reasonably necessary for the training program, qualification of housing programs for moderate-income families only to promote racial integration or prevent community deterioration but not as an end in itself. Others regard such restrictions and distinctions as reasonable, and in virtually no case has the Service refused any foothold to a newly emerging charitable concept; indeed, in the great majority of cases reviewed, new charitable programs have been permitted to develop into full operation on a generally unrestricted basis.

As long as the statutory standards remain broad enough to accommodate meanings that change and expand as the needs of society change and expand, as we believe they should and must, a balance of cautionary and innovative viewpoints seems preferable to any monolithic or doctrinaire approach to the question of what constitutes a "charitable" purpose. The interaction between caution and inspiration which has characterized the Service's approach to this question, although undoubtedly delaying recognition of some new charitable concepts longer than their proponents believe desirable and resulting in tax-subsidized social innovation more than others believe to be appropriate, seems on the whole to have been healthy.

Initial Determinations

District Level

Procedure. Applications for recognition of exempt status are initially filed in the Internal Revenue district in which the organization's principal office is located, but they are referred to the District Director of the nearest "key district." Within each of the 19 key district offices,[61] the Audit Division staff includes an average of 20 to 30 revenue agents and tax auditors designated as "key district specialists" who handle only exempt organization matters. In most key districts, about two thirds of these specialists are assigned to an Examination Group and one third to a Determination Letter Activity Group, each headed by a group manager.[62] A Regional Exempt Organization Program Coordinator in each of the seven Internal Revenue regions coordinates audit programs and monitors the workload of all key district specialist groups within the region, reporting to the Assistant Regional Commissioner (Audit). These are the only field personnel who concentrates full time on exempt organization matters.

Each application is first reviewed by the manager of the key district Determination Letter Activity Group for completeness and to ascertain whether the application should be referred to the National Office for further processing. The published Revenue Procedure requires referral to the National Office only of applications "which present questions the answers to which are not specifically covered by statute, Treasury Decision or regulation, or by a ruling, opinion, or court decision published in the Internal Revenue Bulletin."[63] However, the official Internal Revenue Manual for guidance of IRS employees further restricts field authority by providing that key district offices must also refer to the National Office all applications for exemption which involve "matters of extensive public interest," that is, "those in which the organization, its officers, or its activities are likely to generate Congressional, mass media, or other wide-spread public interest."[64] In addition, whenever a key district finds that at any one time it has two or more applications from organizations of the following types, instead of referring the applications for a National Office ruling on an individual basis it is to request technical advice on the common issues without identifying the organizations by name: (a) urban economic development organizations; (b) homeowners' association; (c) low-and moderate-income housing organizations; (d) fund-raising events for charity; (e) organizations providing administrative services for charities (except IRC 501(e) organizations); and (f) public interest law firms.[65]

About 20,00 determination letters are issued each year by key District Directors upon applications for all types of exemption under sections 501 and 521 (farmers' cooperatives).[66] In recent years the National Office has issued about 1,700 rulings annually on 501(c)(3) applications referred to it by key districts.[67] The Service reportedly forecast in 1968 that by 1970 substantially all problems raised by applicants would be covered by published Revenue Rulings so that all applications could remain under field jurisdiction.[68] The complexities introduced by the Tax Reform Act of 1969 and the steady increase in volume[69] are among the factors that have led the National Office to assume jurisdiction over so many 501(c)(3) determinations.

If an application is not forwarded to the National Office for a ruling, it is assigned to one of the key district specialists for preparation of a determination letter in the name of the key District Director.

All unfavorable determinations (plus a sampling of 10 to 30 percent of favorable ones) are reviewed by the group manager of the key district's Determination Letter Activity Group. If the group manager agrees that the requested exemption should not be recognized, an adverse determination letter is sent to the applicant containing a concise statement of the facts on which the determination is based, the pertinent law and regulations and their application to the facts. The letter also provides notice of the applicant's right to protest the determination by submitting within 30 days a written statement of the facts, law and argument in support of its application, and of the applicant's right to request a conference in the key district office.[70] If no protest is received within 30 days, the determination becomes final and the applicant's local District Director is so notified.[71]

Upon submitting a written protest, the applicant may proceed to a key district office conference,[72] with automatic referral of the case thereafter to the National Office if the key district's position remains unchanged and the organization continues to disagree.[73] Alternatively, the applicant has the right to waive a district level conference and have the adverse determination referred immediately to the National Office,[74] specifying also whether a National Office conference is desired in the event an adverse decision is indicated.

No data are available on either the total number of district conferences in 501(c)(3) determination cases or the number in which such conferences result in issuance of a favorable determination letter. Experienced observers estimate that properly protested denial letter which are reviewed by the National Office are reversed in a substantial percentage of the cases[75] but that the outcome of district conference is much less often favoragle to the applicant. In considering whether to waive a district conference,[76] the applicant thus must weigh the delay and expense of representation before the National Office and of a possible trip to Washington for a National Office conference against the greater likelihood of success in the National Office and the additional time required (during which potential donors have no assurance that contributions will be deductible) if an unsuccessful district conference precedes eventual National Office review.

District conferences are conducted by a "specialist conferee" from the Conference Staff of the key district's Audit Division who typically is familiar with, but does not devote full time to, exempt organization matters. Both the conferee and the manager of the Determinaton Letter Activity Group of key district specialists report to other Service officials within the key district's Audit Division, but the responsibility of such higher officials extends only to wrokload management and administration; they do not participate in determining whether exempt status should be recognized.

Processing time and workload. The Service's Exempt Organizations Audit Procedures specify that determination letters "will be issued within 60-90 days after receipt of the application by the key district unless this is not possible due to delays beyond their control."[77] No specific data are available on the extent to which this objective is met; the National Office Audit Division estimates that determination letters in cases *not* referred for National Office rulings are isssued to most applicants within 30 days after key district receipt of the application, to 80 percent of applicants within 60 days, and to 99 percent within 120 days. Since approximately 20,000 exemption determination letters are issued by key District Directors each year, this would indicate that about 4,000 take more than two months to issue and about 200 take more than four months; it seems reasonable to assume that nearly all of these are 501(c)(3) determinations.

The Service believes that a principal reason for delay is the time it takes for applicants to respond to key district requests for further information, particularly if an amendment to the applicant's charter is required. Some attorneys who regularly represent applicants feel, however, that at the district level the Service is requiring unnecessary paperwork, sometimes requiring, for example, that copies of the applicant's bylaws be supplemented by a certificate stating that the copies are accurate.[78] Unnecessary delays are also attributed to inadequate familiarity by some key district personnel with pertinent Revenue Rulings and regulations, from an overly literal application of rulings or regulations in clearly distinguishable circumstances, and from reluctance to exercise judgment. At the same time, the complex requirements of the pertinent law and aregulations, especially since the Tax Reform Act of 1969, are often not adequately understood by applicants or their attorneys.

About 580 professionals are assigned to the exempt organization program in the field, but there are not avaiable data indicating how much time of Service personnel is devoted to determining the status of applicants for exemption. Since the Service reports and budgets man-years by organizational component rather than by function, and since the determination function is performed by personnel of both the Audit and the Technical components, who perfrom other functions as well, neither the Audit nor the Technical man-years devoted to exempt organization matters (nor both combined) will yield this information.

Personnel and training. All of the Service's field personnel assigned as key district specialists are revenue agents or tax auditors, both of which are job classifications established by the Civil Service Commission for accountants. Tax auditors, with lesser formal accounting training, may reach Grade 9 (currently $12,841 per year); revenue agents may reach Grade 14 in supervisory position (currently $25,581 per year). There is no separate Civil Service job classification for exempt organization specialists, much less for charitable organization specialists.

The normal career ladder for tax auditors is to become revenue agents through additional accounting training; the Audit Division's field staff as a whole is comprised largely of revenue agents. However, most of the key district specialists assigned to Determination Letter Activity Groups are the lower-graded tax auditors, many of them with long years of service at that level. This difference is reflected also in supervisory grade levels; the managers of Determination Letter Activity Group (while themselves revenue agents) are all at Grade 12 or 13, whereas half the supervisors of Examination Groups are at Grade 14.

The grade structure for key district specialists was somewhat improved in 1969, but there has lingered an inclination (privately acknowledge within the Service as well as outside) not to regard exempt organizations specialists in the field with the same esteem as those engaged in "productive" activities. However unjust this may be to able individuals, the inevitable consequence has been a tendency for ambitious field personnel to seek assignments outside the exempt organizations area, consistent with the predominant emphasis of the Service as a whole on revenue-collecting productivity. It is not unusual to find a key district specialist at Grade 9 after 20 years service.

Training of key district specialists for the determinations function consists of a four-week course based on the Exempt Organizations Handbook (initially isssued by the National Office's Technical staff in January 1970 and updated concerning 501(c)(3) organizations as of April 1972),[79] plus a one-week course on Private

Foundations Under the Tax Reform Act of 1969. The latter course is based on study materials current as of the end of 1971, before final Treasury Regulations were issued on most of the lesson topics. The basic four-week course, using the Exempt Organizations Handbook as a guide, is built around six case problems, of which two involve 501(c)(3) organizations and the remaining for involve applicants under other exemption provisions of the Code.

The written materials for both courses deal with the technical requirements of the law, Treasury Regulations and Revenue Rulings, or with the Service's internal procedures for processing exemption applications. None of the material deals with the purposes, functions, or values of private philanthropy in our society, nor does it include any "refresher courses in fields such as sociology, political science, economics, philosophy and the like" anticipated by Commissioner Thrower when he first established the training program in 1969.[80]

These courses are given in each of the seven Internal Revenue regions (occasionally on an interregional basis) whenever there are enough newly assigned key district specialists to justify it, usually a total of three or four times each year throughout the country. Each course is given by two instructors, one a senior key district specialist and the other from the National Office Audit Division's Exempt Organization Examination Branch. New key district specialists receive on-the-job training within their districts while awaiting an opportunity to take these courses.

National Office: Exempt Organizations Branch, Technical

Determination issues and all other substantive questions forwarded to the National Office for rulings or for technical advice are referred to the Exempt Organizations Branch of the Miscellaneous and Special Provisions Tax Division under the Assistant Commissioner (Technical). The Technical exempt organization experts have neither authority nor responsibility for the selection, training, or management of the key district field personnel whose decisions they are reviewing,[81] since these personnel, as noted above, are members of the audit staff, under the Assistant Commissioner (Compliance).

Procedure. Whether an issue is presented to the National Office for a ruling or for technical advice to a District Director, and whether the issue arises through an exemption application, as a result of an audit or upon a request for an advance ruling, the procedure in the National Office is essentially the same. Normally the case will be handled and the issue resolved entirely within the Technical's Exempt Organizations Branch, after being reviewed at successive levels within that Branch according to the degree of difficulty, novelty, or sensitivity. If the case is unusually important, complex, or sensitive, the Interpretative Division of the Chief Counsel's Office will be consulted for legal advice.

The Exempt Organizations Branch, consisting of about 110 professional and 40 clerical employees, is divided into four sections plus a small service unit that keeps track of each case and its relevant files. The Branch Assignment Officer determines the specific group within one of the Rulings Sections to which each case is to be assigned; the group supervisor then determines the order in which cases should be handled.[82] There are two Rulings Section, each broken down into three groups with each group consisting of approximately 15 tax law specialists, a conferee-reviewer and a group supervisor who also acts as a conferee-reviewer. All six rulings groups handle 501(c)(3) matters and other exemption cases as well; assignments are made between the two sections and among the group primarily with a view to evenness of workload.

The remaining two sections of the Branch are essentially companions to the rulings function. The Conference and Review Staff conducts conferences with representatives of the affected organization when the ruling or technical advice indicated by the Rulings Section is adverse, assists in resolving differences between the Chief Counsel's Office and the Exempt Organizations Branch, and draft Revenue Rulings. The Technical Research and Coordination Section conducts studies in depth to formulate a Branch position on particular problems. This section also maintains liaison with other branches of the Service and Treasury, reviews draft Treasury Regulations, and is responsible for portions of the Internal Revenue Manual. Since 1972 it has been the policy of the Branch to move its personnel periodically among the Rulings, Conference and Review, and Technical Research and Coordination Sections, to improve perspective and deepen expertise. These sections work closely together and confer on difficult issues.

An exemption ruling or technical advice request upon an adverse determination letter is first assigned to a tax-law specialist in one of the rulings groups. His proposed disposition of the case is reviwed by a conferee-reviewer at group level. If they agree and the case does not raise difficult issues, a letter ruling is issued; if the proposed disposition is unfavorable the applicant will first be invited to a National Office conference, conducted either by the rulings group conferee-reviewer or by the Conference and Review Staff, depending on the difficulty of the case.[83] If the rulings group reviewer does not agree with the specialist on a proposed ruling, or if the issue is new or substantial, the supervisor of the rulings group will be consulted; he in turn may bring the case to the Rulings Section Chief. If the Section Chief feels that the problem is substantial or involves a major policy question, he will consult the Conference and Review Staff; if they disagree, the matter will be considered at a "technical issue meeting" of the Section Chiefs and the Branch Chief. If the case involves a new position or a major modification of an old position, or is unusually sensitive, it may be forwarded by the Chief of the Conference and Review Staff (acting for the Director of the Miscellaneous and Special Provisions Tax Division) to the Interpretative Division of the Chief Counsel's Office.

Upon receipt of the Chief Counsel's opinion (GeneraL Counsel Memorandum or "GCM"), the original rulings group will normally dispose of the case in accordance with that opinion. However, such opinions are advisory only; if the Chief Counsel's Interpretative Division disagrees with the Exempt Organizations Branch's proposed action, and the Branch adheres to its view, a "reconciliation conference" will be held between Technical's Miscellaneous and Special Provisions Tax Division (acting through the Chief of the Exempt Organizations Branch's Conference and Review Staff) and Chief Counsel's Interpretative Division. If the reconciliation conference does not produce agreement, the issue will be resolved between the Assistant Commissioner (Technical) and the Associate Chief Counsel (Technical) or the Chief Counsel (or his Deputy).[84] In rare cases it may go to the Commissioner.[85]

Thus, within the Exempt Organizations Branch alone, there may be as many as six successive levels of consideration in difficult cases, with a minimum of two levels even in routine cases: (1) Rulings group: tax-law specialist; (2) Rulings group: conferee-reviewer; (3) Rulings group supervisor; (4) Rulings Section Chief; (5) Conference and Review Staff; (6) Branch Chief (technical issue metting).

To these levels of review must be added those potentially resulting from consultation with the Chief Counsel's Office: (7) Chief Counsel's Interpretative Division; (8) Miscellaneous and Special Provisions Tax Division (Technical) and Chief Counsel's Interpretative Division (reconciliation) conference; (9) Assistant Commissioner (Technical) and Associate Chief Counsel; (10) Assistant Commissioner (Technical) and Chief Counsel.

Perhaps 100 to 200 exempt organization cases per year are referred to the Chief Counsel's Office. Such referral, of course, adds considerably to the amount of time required for ultimate disposition. About an equal number of cases, although not so referred, are held in the Exempt Organizations Branch pending resolution of controlling questions that are awaiting disposition in similar cases that have been referred to the Chief Counsel's Office.

Workload. The professional staff of the Exempt Organizations Branch, most of whom are attorneys, has approximately doubled in size since 1968, primarily because of the increased complexity and sophistication of the issues presented under the Tax Reform Act of 1969. Although the volume of work has not changed much in recent years, the normal docket for an experienced tax law specialist has decreased from about 40 cases in 1968[86] to between 10 and 20 cases today. The Branch believes it is adequately staffed for its present functions at its currently authorized level.

In 1968 the estimated "normal" time spans for processing cases were as follows: four months from the initial unfavorable determination to an invitation to a National Office conference (including about 30 days for submission of the applicant's brief), another 30 to 60 days until the conference,[87] three weeks for the applicant's post-conference brief, and then additional time for consideration of the case at appropriate levels within the Exempt Organizations Branch or, if necessary, in the Chief Counsel's Interpretative Division.

These delays have been a source of complaint because they can result in the financial death of a new charitable organization.[88] In recent years, the Exempt Organizations Branch has tried to reduce the number of protracted cases. Monthly status reports required by the Branch Chief have shown a sharp and steady decline since 1970 in the number of cases pending for more than six months:

	Total E.O. Cases Pending over 6 Months in National Office	Rulings Requests	Technical Advice Requests
December 1970	788	649	139
December 1971	435	331	104
December 1972	269	209	60
December 1973	279	232	47
December 1974	234	191[a]	43

a. About 65 of these are requests for advance rulings on private foundation scholarship programs; although advance Service approval of grant procedures is required by Code §4945, the Service has not yet issued a Revenue Procedure specifying the criteria for approval of such procedures. See page 2603 below.

As of December 31, 1974, the majority of National Office cases were being closed within two months and about 90 percent within six months, as shown by the following data:

Percentage of E.O. Cases Closed Within Two Months and
Within Six Months of Receipt in National Office

	Within 2 Months	Within 6 Months
Rulings Requests	64%	94%
Technical Advice Requests	63	90

Organizations (and their attorneys) proposing new forms or concepts of charitable activity are more likely than others to experience rulings delays, particularly if the proposed activity is controversial.[89]

Staff and training. Unlike the key district specialists in the field, most of whom served in other Internal Revenue Service capacities (typically as income tax auditors) before becoming exempt organization specialists, the professional staff of the Technical Office's Exempt Organizations Branch is comprised largely of people who entered that Branch from outside the Service. This reflects a deliberate policy of the Branch, adopted several years ago, to provide new perspectives.

Most staff members hired recently by the Exempt Organizations Branch have been young lawyers just admitted to the Bar; the balance are accountants. The Branch deliberately seeks applicants with a broader liberal arts background or experience than the usual Service employee. Recently added staff members have experience with legal aid societies, public defenders and public interest law firms; with the Peace Corps, Federal Trade Commission, public housing, and drug abuse programs, other federal agencies, municipal governments and state conservation programs; two previously served with Nader Groups; one is a physicist.

Although exempt organizations expertise may not lead to the same potentially lucrative post-Service opportunities that have traditionally attracted able personnel to, for example, the Corporate Reorganizations Branch, the Exempt Organizations Branch believes that an offsetting factor enabling it to compete successfully for quality personnel in recent years has been the increased interest of younger professionals in public-service occupations.

Entry level for tax-law specialists in the Branch is GS-9 (currently $12,841 per year); new attorneys enter the Chief Counsel's Office or the Department of Justice at GS-11. Journeyman level in the Branch is GS-12 (at $18,463), with senior specialists and conferee-reviewers at GS-13 ($21,816). Group supervisors are at GS-14, Section Chiefs at GS-15 and the Branch Chief at GS-16.

New professional employees entering the Exempt Organizations Branch undergo a three-month, on-the-job training program which occupies about half of their time. In addition to subjects and materials covered by the key district specialist training courses, the Exempt Organizations Branch training includes a 6-to 8-week seminar program, meeting for two or three 2-hour sessions per week, covering some 26 specialized topics. Most of the seminar meetings are conducted by Branch personnel; two are conducted by members of the Chief Counsel's Office, and recently one session each has been conducted by a staff member of the Joint Committee on Internal Revenue Taxation and by the chairman of the Exempt Organizations Committee of the American Bar Association Tax Section. Twelve of the 26 seminar topics related to 501(c)(3). The Chief of one of the Rulings Sections is in charge of the training program, assisted by a Branch training officer who reviews and evaluates the progress of each trainee. The training program is presented whenever there are 10 to 12 new staff members ready for it, usually twice a year; in the last few years, an average of one trainee per year has transferred to other parts of the Service upon washing out of the training program.

Attorneys experienced in practising before the Service generally agree that the Branch's staff has improved considerably over recent years, but opinion varies on how it compares with other Technical branches in the National Office. If there is any consensus, it seems to be that Exempt Organizations Branch personnel are superior to other Service personnel concerned with exempt organization matters but that there remains a need for further improvement. One criticism is that, as in any large bureaucracy, work is so subdivided that few individuals can acquire adequate perspective. This tendency may be aggravated by the number of review levels and by the fact that the Service officials who exercise ultimate authority, and some intermediate officers as well, are not themselves exempt organizations experts.

National Office: Office of the Chief Counsel

Every exemption determinaton (like every tax question) presents a "legal" issue in the sense that it requires a decision on whether and how the statutory words of the Internal Revenue Code apply to a particular organization or activity. The distinction between cases referred for Chief Counsel opinions and those not so referred, therefore, depends on the importance, complexity, and sensitivity of the case, not on whether a "legal" issue is involved.[90]

The Interpretative Division is one of two divisions under the Associate Chief Counsel (Technical),[91] serving under the Chief Counsel who is the "chief law officer" for the Service as an Assistant General Counsel of the Treasury Department.[92] The Division reviews interpretations of the Code and regulations, and prepares formal opinions of the Chief Counsel. The Division has about 50 attorneys, including a Director and 5 Branch Chiefs. The five Branches are simply administrative units for distributing the Division's workland.

Although the Division has no formally designated areas of specialization,[93] three docket attorneys work exclusively on exempt organization matters and about three others devote half their time to such cases. All opinions on exempt organization matters are reviewed by one of four individuals in Branch 5 – the Branch Chief, two Assistant Branch Chiefs, and recently one additional attorney-reviewers.[94]

We have no data on the annual volume or disposition of exempt organization matters in the Chief Counsel's Office, or on the time required to dispose of individual cases. Recently the Chief Counsel's office began maintaining a record of the number of cases pending. As of July 31, 1974, there were 98 exempt organization matters pending in the Chief Counsel's office, of which 43 were particular exemption qualification cases including some arising under provisions other than 501(c)(3). The other 55 matters were proposed Revenue Rulings on issues that had already been decided in individual cases. Pending issuance of Chief Counsel opinions, 50 to 100 additional cases involving similar questions were being held in Technical's Exempt Organizations Branch.[95]

The staff of the Chief Counsel's office is generally well regarded professionally. However, within the Service as well as outside there is frustration with the time required for Interpretative Division opinions. A principal factor producing delays in the Division has been a staff shortage at the reviewing level. Docket attorneys with several years experience are typically at GS-13 or 14; just when they are qualified to become reviewers, the competition of private firms for tax lawyers becomes most attractive. The resulting shortage creates a review bottleneck in all areas, not merely exempt organization matters. In recent years about 500 pending cases of all types have been carried over by the Interpretative Division from one fiscal year to the next; nearly 40 percent of these are typically pending at the review level.

The apparent volume of exempt organization cases, and the unusual breadth of judgment required for their disposition, would seem to justify a specialized legal staff for exempt organization matters. Increased staff at the reviewer level also seems appropriate for such cases, in view of the severe effects on new charitable organizations from protracted recognition delay. There are indications that the Chief Counsel's office may now be considering an exempt organizations unit; as noted earlier, the office has recently begun identifying the portion of its workload consisting of exempt organization cases. Consideration is being given to the creation of a new Assistant Director of the Interpretative Division for Employee Plans and Exempt Organizations, paralleling the responsibilities of the new Assistant Commissioner, but apparently no decision has yet been made on establishment of an Exempt Organizations Branch of docket attorneys.

Revocation and Modification

A determination letter or ruling recognizing 501(c)(3) exemption may be revoked or modified (for example by according the organization 50l(c)(4) status which is tax exempt but not eligible to receive deductible contributions) if the Service finds either that 501(c)(3) status should never have been recognized or that as a result of factual or legal changes the organization no longer qualifies for 501(c)(3) exemption. The organization may not challenge the revocation or modification in court unless and until it (or a donor) is assessed for taxes.

Procedure. Revocation or modification of exempt status is initiated by a letter to the organization from the key District Director advising of the proposed action and the reasons therefor. Except when the action results from a change in the applicable legal requirements (for example a statutory change or published Revenue Ruling altering the exemption qualification standards previously applied), it is normally a consequence of information developed during an audit. The organization generally has an opportunity to discuss the problem with the revenue agent conducting the audit and to submit further information to him.[96]

Once the key District Director notifies the organization of a proposed revocation or modification of its status, the procedure and the organization's rights to protest are the same as those following a District Director's determination letter denying 501(c)(3) status upon an initial application for recognition, with automatic referral to the National Office for technical advice if agreement is not reached at the District level.[97] Within the National Office, the case is reviewed as described earlier. The only significant difference is that revocation or modification, unlike an adverse initial determination of status, also presents the issue of retroactivity. In addition, in some instances there may be an alternative to revocation or modification that is not available in the case of an initial application, that is, assessment of an unrelated business tax.

Retroactivity. Section 7805(b) of the Internal Revenue Code permits the Secretary of the Treasury or his delegate to prescribe the extent, if any, to which any tax ruling or regulation shall be applied without retroactive effect. This authority has been successively delegated, with exceptions not pertinent here, to the Assistant Commissioner (Technical), whose personal approval is necessary for each case of relief from retroactivity under section 7805(b).[98]

In exempt organization cases, the Service provides that revocation or modification "may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or engaged in a prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purposes, and such transaction involved a substantial part of the corpus or income of such organization.[99] If the exemption is no longer appropriate due to changes in the organization's character, the revocation or modification may be retroactive to the year in which the changed conditions or activities began, depending on whether the organization notified the Service of such changes at the time.[100] A revocation or modification due to changes in the applicable law or Revenue Rulings is normally effective as of the year in which the law changed.[101] In any event, revocation or modification will ordinarily take effect no later than the time at which the organization received written notice of the proposed action.[102]

If the key District Director believes that a proposed revocation or modification should not have complete retroactive effect, he must submit his recommendation with supporting reasons through the Exempt Organizations Branch of the National Office's Technical staff to the Assistant Commissioner (Technical) for approval, regardless of whether the affected organization agrees with the proposed action.[103] On the other hand, the organization must be notified by the key District Director if the action is proposed to be applied retroactively, and the reasons therefor.[104] It is then up to the organization to protest the retroactivity as a separate issue in the course of its administrative appeals. If the organization does not itself raise the issue, it will be resolved without the organization's assistance; a second referral for technical advice or a section National Office conference will not be permitted on the issue of retroactivity alone.[105]

Since the deductibility of contributions by donors also depends on an organization's 501(c)(3) status, any change in that status will affect the donors as well as the organization itself. Contributors and grantor foundations thus have a substantial interest in any revocation or modification of any organization's 501(c)(3) status, including particularly any retroactive application of such change.

Generally, contributions to an organization by persons unaware that the recipient has ceased to qualify under 501(c)(3) continue to be deductible if made before the Service has published an announcement in the Internal Revenue Bulletin that contributions are no longer deductible.[106] This requires careful contributors to monitor issues of that bulletin, without waiting for the periodic updating of IRS Publication No. 78, *Cumulative List of Organizations Described in Section 170(c) of the Internal Revenue Code of 1954.*

Advance assurance of deductibility may be suspended in some cases without awaiting final revocation or modification of 501(c)(3) status. If the District Director upon preliminary information has "serious doubt concerning the continued qualification" of an organization, he may afford the organization an opportunity for a written protest and district conference within 10 days before recommending to the National Office that advance assurance to contributors be suspended. Upon such a recommendation the National Office will provide an immediate conference to the organization. If it then concurs with the District Director's recommendation, the National Office will publish in the Internal Revenue Bulletin a notice that assurance of deductibility of contributions has been suspended and notify the district office to publish a local press release to the same effect. In "extraordinary circumstances for good cause shown," the Assistant Commissioner (Technical) may take such action without preliminary notice to the organization or any opportunity for protest and conference.[107] Suspension of advance assurance of deductibility was utilized by the Service in numerous cases of racially segregated private schools during the period 1971-1972.[108]

Unrelated business activities and 501(c)(3) status. A proposed revocation in a close or difficult case, in which a substantial part of an organization's activity is the conduct of a business that is arguably unrelated to its exempt purpose, can sometimes be resolved by leaving the organization's 501(c)(3) status undistributed but assessing an unrelated business tax under section 511 on the income from the particular activities that gave rise to concern. The broad language of section 501(c)(3) and of the unrelated business tax provisions (sections 511-515), and particularly the amorphous language of the pertinent Treasury regulations, facilitate such a resolution in some cases.[109]

Section 501(c)(3) requires that an organization be "organized and operated exclusively" for charitable purposes. Prior to the Revenue Act of 1950, the Service took the position that an otherwise exempt organization could not qualify for exemption if it engaged in business, even if it also carried on a charitable program or if the business activity was merely a "feeder" for such a program. In 1950 Congress provided that such activities were to be subject to an unrelated business tax if not "substantially related" to the performance of the organization's exempt purpose,[110] but were not to affect exempt status.[111] The Service reflected the change by a Treasury Regulation specifying that such business activities, even though substantial, do not disqualify an organization for 501(c)(3) status if the business activities are "in furtherance of" the organization's exempt purpose and are not themselves the organization's "primary purpose."[112] However, the regulations also provide that an organization is not "organized exclusively" for exempt purposes as required by 501(c)(3) if it is empowered by its charter to engage in business "otherwise than as an insubstantial part of its activities,"[113] and that an organization is "operated exclusively" for exempt purposes as required by 501(c)(3) only if engaged "primarily" in activities "which accomplish" such purposes with "not more than an insubstantial part of its activities" in furtherance of other purposes.[114]

The application of these regulations requires the finest semantic distinctions between activities that are "substantially related to," those "in furtherance of" and those "which accomplish" exempt purposes, as well as between an organization's "primary" purpose and its other purposes. The Service advises its own employees that, "The regulations' terms 'exclusively,' 'primarily' and 'insubstantial' present difficult conceptual problems," and that questions involving application of these terms "can more readily be resolved on the basis of the facts of a particular case."[115] There are no published Revenue Rulings construing these terms, and virtually no judicial precedents,[116] thus leaving the Service free in some cases to find that a business activity, though a substantial part of an organization's operations, has not become the organization's "primary" purpose (which would require revocation) but instead is merely taxable as not being "substantially related" to an exempt purpose.

It would be misleading, however, to assume that such a "compromise" is readily resorted to whenever a difficult 501(c)(3) revocation case involves business activities. The unrelated business tax is applicable to numerous other categories of exempt organizations. The service is well aware that efforts to rationalize the requirements of the unrelated business tax provisions with those of section 501(c)(3) must be applicable also, on a consistent basis, to similar activities conducted by other categories of exempt organizations.[117]

Frequency of revocations and modifications. There are no data available on modifications of status, but the Service has furnished figures on final revocations posted to the Exempt Organization Master File (EOMF) as follows:

	FY 1971[a]	FY 1972	FY 1973
501(c)(3) organizations	220	78	117
Other exempt organizations	629	256	233
Total	849	334	350

a. The FY 1971 figures represent cumulative data from the time the EOMF was established in 1964-1965.

The Commissioner's Annual Report for FY 1969 reported 167 revocations recommended by examiners (auditors) that year, or less than 1.5 percent of the 11,845 exempt organization returns examined. Similar figures were not provided by subsequent annual reports until FY 1973, for which the Commissioner reported 251 revocations recommended, or less than 1.2 percent of the 22,028 exempt organization returns examined that year.[118] Neither report identifies how many 501(c)(3) organizations are included in those figures or how many recommendations led to actual revocations, and there appears to be no reliable way to relate those figures to the final revocation figures shown above. In the absence of additional information, the only available data suggest that annually between 1 percent and 2 percent of exempt organization audits lead to proposed revocations, with obviously some lesser percentage resulting in actual revocations[119] and an unknown mix of status modifications.

Advance Rulings on Proposed Transactions

At the written request of any taxpayer, the Service will issue a ruling on the tax effects of particular transactions proposed to be entered into by the taxpayer. Requests for such "private letter rulings" must be submitted to the National Office's Technical staff with a statement of facts, copies of relevant documents, and the requesting taxpayer's analysis of the tax issues involved. Intended to provide reliable guidance when the tax consequences of an imminent transaction may have an important effect on the consummation or shaping of the transaction—typically where the stakes are too high for the parties to proceed without such assurance, as in a corporate sale or merger—such advance rulings are issued directly to the taxpayer. If the transaction is then consummated, a copy of the ruling letter must be attached to the taxpayer's return for the year involved.[120] About 30,000 such advance rulings are issued by the Service each year.[121]

This procedure applies also to exempt organizations. Indeed, determination rulings on exemption qualification are regarded by the Service as merely a particular variety of such advance rulings, albeit an unusual one in volume.

No information is available on advance rulings (other than for exemption determinations) requested by or issued to exempt organizations generally. However, the Service has made public the following data on the number of requests by private foundations for advance rulings under the Tax Reform Act of 1969 (not including foundation status classification rulings):

Period	Tax Reform Act Advance Ruling Requests
Month of December 1960	20
Calendar 1971	380
Calendar 1972	416
Calendar 1973	1,221
January - March 1974	314

The recent increase primarily reflects requests for Service approval of private foundation procedures for making grants and scholarships to individuals.[122] These rulings requests encounter an organizational problem within the Service: although foundations are required by section 4945 to obtain advance Service approval of such procedures, and these requests must be submitted for approval to the Exempt Organizations Branch (Technical), that Branch has referred such rulings requests to the Individual Income Tax Branch (Technical) for review in light of Code section 117, which excludes from an individual taxpayer's "gross income" amounts received as scholarships or fellowship grants. The Individual Income Tax Branch, primarly concerned that company-sponsored foundations may be used as a device for compensating company employees by granting scholarships to their children, has taken a much more restrictive approach to such grants than those concerned with philanthropy feel is necessary or appropriate. The inability thus far of Technical's Individual Income Tax Branch and Exempt Organizations Branch to resolve their differences of approach has delayed approval of dozens of foundation scholarship programs whose rulings requests have continued for many months to remain pending.[123] In the meantime, any foundation grant or scholarship made to individuals without advance Service approval of the grant-making procedures would subject the foundation and its managers to penalty taxes under section 4945.

Such protracted delay due to an intra-Service organizational impasse seems an unduly high price for philanthropy to pay in the name of ideally coordinated interpretations of related Code provisions. We believe the Service should establish a more effective mechanism for resolving such internal differences, and that when the differences arise from a rulings request that is required to be submitted under the Code's exempt organization provisions, as in this instance, final responsibility should be accorded the Service unit charged with interpreting those provisions.

The Service has generally applied to philanthropy the same policy against issuing advance rulings on questions of fact that it applies under other areas of the Code; this includes determinations of fair market value. Several provisions of the Code relating to valuation of foundation-owned property and to transactions between foundations and their disqualified persons (who may constitute the only practical market for Code-mandated disposition of a foundation's excess business holdings) turn upon determinations of fair market value.[124] Without an advance ruling, severe penalties may result from good faith transactions if the Service subsequently disagrees on valuations. We understand that the Service is currently attempting to develop criteria for approval of such determinations.[125]

Compliance Functions

About 72 percent of the Service's budget for exempt organizations matters is expended in performing compliance functions, that is, monitoring and enforcing compliance by exempt organizations with the Code's requirements.[126] These resources have been concentrated overwhelmingly on private foundations. For example, in FY 1973 the Service audited 14,958 private foundations, 2,046 other 501(c)(3) organizations, and 1,976 organizations in all other exempt categories,[127] even though the 25,133 private foundations constituted less than 12 percent of the 220,074 active 501(c)(3) organizations and less than 4 percent of the total 643,586 active exempt organizations known to the Service,[128] and foundation grants accounted for only 9.6 percent of private charitable contributions in 1973.[129]

We first review the organization and conduct of the Service's exempt organization audit program, and then its results.

Organization of Compliance Activities

As noted earlier, the Service's field organization in the exempt organization area consists of about 580 revenue agents and tax auditors who are members of the audit staff at the district level, serving under the managerial direction of the Audit Division Director in each of the 16 key districts, with a Regional Exempt Organization Program Coordinator under the Assistant Regional Commissioner (Audit) coordinating audit programs and monitoring key-district workloads in each of the seven Internal Revenue regions. Approximately two thirds of the key district specialists are assigned to Examination Groups performing the audit function; the balance are assigned to Determination Letter Activity Groups. Consistent with the Service's general organizational structure separating administrative supervision in the field from functional supervision by the National Office in Washington, all exempt organization field personnel are subject to the functional supervision of the National Office's Audit Division under the Assistant Commissioner (Compliance).

National Office Audit Division

Both the Peterson Commission and congressional hearings on the Tax Reform Act of 1969 focused attention on the need for a more vigorous exempt organization audit program by the Service. As a result, Commissioner Thrower in 1969 established for the first time an Exempt Organization Examination Branch in the National Office's Audit Division. Staffed by about 20 professionals, the Branch was divided in 1972 into a Procedures Section and an Examination Section, with the latter then being assigned responsibility also for the Audit Division's pension trust program.

The Examination Section, comprised of about 10 people (of whom three handle only pension trust matters), perform two main functions: first, it designs and monitors an annual exempt organization audit plan to be implemented by the field staff, which includes subject areas to be examined and predetermined audit cycles for various types of exempt organizations; and second, it prescribes uses to be made of the computerized Exempt Organization Master File (EOMF) data in determining selection of exempt organization returns for audit and for other purposes.

The Procedures Section also has two main functions: (1) conducting pre-closing reviews of all audits of exempt organizations that are on the "National Office Controlled Case" list, and (2) maintaining liaison with other Service branches in matters affecting the exempt organization audit program and responding to inquiries on such matters from persons outside the Service.

The National Office Controlled Case (NOCC) list was established in 1969 to designate particular exempt organizations which, for reasons of sensitivity, complexity of issues, and asset and income size, were to be audited every two years under a closely monitored procedure. With few exceptions only large private foundations were selected for the NOCC list, which grew from 582 foundations in September 1969 to 673 in December 1971. As experience indicated that the operations of many foundations on the list were relatively simple and trouble-free, the list was thereafter reduced to 369 foundations. In 1973 the Service altered its concept of the NOCC program by eliminating sensitivity and income level from the factors determining selection for the list, limiting the list to "private foundations with substantial total assets and presenting a degree of complexity in their operations."[130] There are currently 102 foundations on the NOCC list.

The Service describes the purpose of National Office pre-closing reviews of NOCC audits as being "to ensure national uniformity and to identify and assist in resolving real or potential problems," with the expectation that such review "will result in improved quality of examinations; uniformity in application of law, regulations, etc.; identification of needs for legislation, regulations, rulings, etc.; identification of training needs; and other similar benefits."[131] No data are available on how often such National Office preclosing review results in disagreement with the key district's conclusion or in a return of the case to the district for further development, but the Service estimates that there is cause for National Office comment in about 20 percent of the NOCC cases reviewed. Revenue agents conducting audits, while permitted to discuss all facets of the audit with an organization on the NOCC list, are directed not to "volunteer information that the case is subject to National Office review."[132]

In addition to foundations on the NOCC list, the National Office also controls audits of "nationally known" churches (or conventions or associations of churches). No such audit may be commenced without prior approval of the National Office, and then only after the district office has twice made unsuccessful efforts to obtain the desired information without an audit. Upon National Office approval, the Regional Commissioner must give the church 30 days advance notice of the audit, specifying the reason for, scope and extent of the audit. If the church is not "nationally known," National Office approval is not required but the procedure is otherwise the same.[133] While such advance notice is required by Code section 7605(c) for audits of a church's unrelated trade or business activities,[134] the Service requires these procedures for any audit of a church.

The Service also requires that advance approval from the National Office be obtained before commencing an audit in any other "highly sensitive" case. These cases are described as including not only any "nationally known church or religious organization," but also "'a large college or university, or an organization whose examination would probably involve a legal issue for which no Service position has been adopted, e.g., a labor union, hospital, Blue Cross-Blue Shield type organization, etc."[135]

Advance concurrence by the Assistant Commissioner (Compliance) is required before issuance by local district offices of any press release warning the general public that potential patrons of a fund-raising event may not rely on misleading solicitations or advertisements. Such a press release is recommended whenever "the solicitation or advertisements are a flagrant disregard of the law or regulations or sponsors of fund-raising affairs have refused to cooperate with the Service and persist in misleading the public." However, the Service's instruction to field offices on this subject is set forth only in the context of erroneous or misleading statements concerning the deductible portion of amounts paid for tickets (or other privileges or benefits) in connection with charitable fund-raising affairs.[136]

Field Level

Under the audit plans and the procedures prescribed by the National Office Audit Division, the exempt organization specialists in each key district's Audit Division designate the particular exempt organization returns to be selected for audit, organize and conduct the audits, and hold district conferences with affected exempt organizations in unagreed cases. We consider below the basis for selecting returns to be audited, the objectives and techniques of exempt organization audits, review and protest procedures, and the training of field personnel for exempt organization auditing.

Selection of returns. While the Service's specific criteria for selecting returns to be audited are not publicly available, the general criteria are indicated by the Service's Manual or Exempt Organizations Audit Procedures. The manual acknowledges that the audit program places "particular emphasis" on audits of private foundations and only a "sampling" of other types of exempt organizations. Nonfoundation returns selected for audit are "those returns which indicate that the organization may be engaged in activities not in furtherance of its exempt purposes or in violation of defined restrictions and requirements.[137] Exempt organizations (other than foundations) whose returns do not on their face raise questions of possible noncompliance, and about which no complaints have been received by the Service,[138] are thus almost sure to remain unaudited.

The selection procedure relies heavily on computer processing. Based on the annual audit program suggested by the National Office Audit Division, each of the seven regions plans the number of audits and man-days to be applied in examining returns to be selected from various categories of exempt organizations within the region. Under procedures adopted in 1974, each key district then submits monthly orders to the Service's Philadelphia computer center for a number of returns designated by category according to nine optional selection criteria. The criteria include type of return (unrelated business income, foundation excise tax, etc.), asset size, income size, type of ruling (individual or group), Code subsection for exemption qualification, activity (private school, museum, etc.), foundation classification (private operating on nonoperating foundation, public charity, undetermined, etc.), and percentage of contributions spent on solicitation expenses. The computer center then assembles and ships to the key district the desired number of returns meeting the specified criteria, together with appropriate audit forms, pre-addressed mailing labels, and so forth.[139]

As an additional source (and until 1974 the principal source) for selecting returns for examination, the Exempt Organization Master File (EOMF) prints out for each key district a quarterly Audit Classification Register (ACR) in two parts, one for private foundations and one for nonfoundations, listing all exempt organizations for which an entry has been posted in the EOMF showing a return filed during the preceding calendar quarter. Key district specialists designate ("classify") the returns to be audited by marking the ACR accordingly and sending it to the computer center in Philadelphia, which then ships back a package including each of the designated returns. The ACR contains data for each organization listed "that are generally of primary interest to classifiers" in designating returns to be audited, including the latest year of return audited (if applicable), the year the audit result was posted to the EOMF, codes for the final result and "principal issues" in such previous audit, the foundation classification, and whether corrective action was reported by the organization if a Form 4720 was filed (Return of Initial Excise Taxes on Private Foundations, Foundation Managers, and Disqualified Persons).[140]

Audit objectives and techniques. The typical audit of a business enterprise consists primarily of verifying financial statements. The audit of a 501(c)(3) return is different since it requires substantive determinations (that is, that a given activity qualifies as charitable) as well as quantitative verification. The audit function is thus more sensitive than might first appear. The Service's manual for its employees includes Tax Audit Guidelines issued in 1965 to revenue agents who regularly audit exempt organizations.[141] Supplemented by audit technique guidelines on requirements of the Tax Reform Act of 1969, which were developed for the Service's training purposes but were made optional for on-the-job use as well,[142] the 1965 Tax Audit Guidelines remain officially the basic directive for audits of exempt organizations.

The Tax Audit Guidelines specify techniques emphasizing: (1) possible application of section 501(e) (Communist organizations),[143] section 502 (feeder organizations), section 503 (prohibited transactions),[144] section 504 (unreasonable accumulation of income),[145] and sections 511-514 (unrelated business income); (2) determination of whether the organization meets both the organizational and operational tests for exemption qualification; (3) detecting inurement to private benefit; (4) compliance with filing requirements for Form 990 and information returns and withholding tax statements; and (5) review of expenditures indicating legal expenses and propaganda or political activities. Additional steps are suggested whenever a business activity is found and in auditing hospitals, clinics, homes for the aged, and scientific or educational organizations. The extent of the examination is to vary with the situation, with office or correspondence audits permitted when appropriate. Every audit, however, must at a minimum verify conformance with the terms and conditions specified in the exemption application and determination letter, inquire into any wage and excise tax liability, and check compliance with filing requirements for information returns and withholding tax statements.[146]

The Audit Technique Guidelines developed for training purposes after enactment of the Tax Reform Act of 1969 are more detailed than the 1965 Tax Audit Guidelines but focus on the identical issues, alerting examining agents particularly to "any possible areas in which income or corpus is being directed toward private interests as investments in closely held corporations, scholarship and fellowship grants, or financial transactions between the organization and its founders, substantial contributors, or persons related to them, etc."[147] The following "objectives" are specified for the audit of 501(c)(3) organizations, in addition to those emphasized by the 1965 Tax Audit Guidelines:

- To evaluate the procedures followed by the organization in accounting for funds disbursed to other organizations, to assure that these funds are properly used by the recipient.

- To determine whether all compensation, fees, allowances, and taxable benefits paid directly or indirectly by the organization are properly reflected on the individual tax returns of the recipients.

- To determine whether the organization qualifies as a private foundation under the Tax Reform Act of 1969. This determination involves:

  (a) Foundation status under IRC 509(a).

  (b) Whether required notification has been made as to such status under IRC 508.

  (c) Possibility of disqualified persons as defined in IRC 4946.

  (d) Applicability of taxes under IRC 4940 (net Investment Income).

  (e) Applicability of taxes under IRC 4942 (undistributed income); and IRC 4943 (excess business holdings).

(f) Applicability of taxes under IRC 4941 (self-dealings); IRC 4944 (investments which jeopardize charitable purposes); and IRC 4945 (taxable expenditures).

(g) Charitable and split-interest trusts treated as private foundation under IRC 4947.

(h) Applicability of taxes and special rules for foreign private foundations under IRC 4948.

The emphasis on chapter 42 excise taxes in private foundation audits should be read, however, together with the Service's 1972 directive on Private Foundation Examination Reports and Procedures, which is a "companion document" to the Audit Technique Guidelines. That directive specifies:

> As envisioned by the Congress, effective enforcement of the chapter 42 provisions is not measured by the amount of tax dollars assessed against and collected from private foundations. Indeed, IRC 507(g) provides for the entire abatement of IRC 507(c) tax where it is shown the assets of an involuntarily terminated private foundation will be used for charitable purposes. Appropriate correction and the preservation of assets for charity are the ultimate goals set by Congress in enacting these provisions.[148]

Formal audit plans for each large foundation on the NOCC list must be prepared in advance by the key district specialist and his supervisor, occasionally with advice and assistance from the National Office. Such plans are to emphasize the organization's activities; they are not to be limited to verification of financial statements. Minute books and project files, for example, are to be reviewed for leads to "questionable activities and problem areas not apparent on the returns." As indications of such problem areas, revenue agents are to be alert to "dubious financial transactions indicative of self-dealing or activities presumably not exempt; questionable statements or assertions on or with the return; apparent excessive accumulations; indications of the conduct of unrelated business; feeder activities, or control of non-exempt businesses where the exempt organization may be a tax-dodge; subversive connections, etc."[149]

Review and protest procedures. Before any audit is closed, the revenue agent's work is subject to review by a key district specialist reviewer. However, in practice the only audits receiving such reviews are those involving proposed modification or revocation of exempt status, change in liability for chapter 42 excise taxes in private foundation audits, NOCC (large private foundation) cases, "sensitive" cases, technical advice or assistance requests, and a sampling of all others.[150]

If a proposed change in the organization's tax liability results from the audit (after pre-closing review by the National Office Audit Division in NOCC cases), the organization is given a copy of the revenue agent's examination report and advised of its appeal rights. Protests in cases other than adverse determinations of status are screened by the Chief of the key district's Conference Staff only if chapter 42 excise taxes or adjustments to unrelated business income taxes are involved.[151]

When taxes are unrelated business income or chapter 42 excise taxes are found due, the affected foundations and individual managers or self-dealers have the same conference and appeal rights as in ordinary income tax cases—district conference and appellate conference at the regional level followed by 90-day notice of deficiency and right of Tax Court appeal or refund suit.[152] There is no automatic right of referral for technical advice to the National Office's Technical staff as there is when exempt status is denied or proposed to be revoked or modified, although the key district may request technical advice as in any other tax case if the examining revenue agent or key district reviewer believes it warranted.[153] (A few regional appellate division conferees have recently started taking the Service's exempt organization training courses in preparation for such cases.) These procedures apply to chapter 42 excise taxes asserted against foundation managers and self-dealers, whose liability for such taxes is determined in conjunction with the private foundation audit, even if the foundation's own liability for returns or tax is not affected; a copy of the examination report asserting tax against such individuals is furnished to the foundation as well as to the affected individuals upon completion of district review.

No protest right or technical review is accorded when an audit leads to a "No Change Advisory Letter." These are ussued when the audit results in a finding that the organization remains entitled for the present to its exempt status but that it has engaged in activities which, if continued or increased, may jeopardize its exempt status in the future. Since no change is made in the organization's tax liability or status, the organization does not receive a copy of the revenue agent's examination report on which such finding is based and is not accorded an opportunity to protest either the factual or the legal premises for the cautionary advice.[154]

Except in cases where a "No Change Advisory Letter" is the ultimate outcome of a proposed revocation or modification that has been taken to the National Office for technical advice, the issuance of such a letter will not have been reviewed by the substantive exempt organization experts of the National Office's Technical Staff. Consequently, the *in terrorem* effect of such a letter can discourage exempt organizations from pursuing activities which, though perhaps controversial, may be entirely permissible by the more sophisticated standards of the National Office's Technical staff, without any opportunity for testing the issue unless the affected organization risks continuing the activity in reliance upon the anticipated favorable outcome of a future revocation proceeding. No specific data are available on the number and type of "No Change Advisory Letters" issued, but the Service estimates that about 100 to 150 such letters were issued during 1973.

Audit personnel and training. Field personnel assigned to exempt organization matters are generally revenue agents or tax auditors experienced in income tax auditing, with the higher-grade revenue agents performing the examination (audit) function while the tax auditors are assigned largely to processing exemption applications.[155] Training for exempt organization audits consists of a four-week examinations course covering all types of exempt organizations, with one third of the course lessons devoted to 501(c)(3) organizations.

The course is conducted by senior exempt organization field specialists, with materials on 501(c)(3) organizations based on (1) extracts from Revenue Rulings issued during the period 1956-1970 and from judicial decisions of the period 1945-1969; (2) references to Treasury Regulations under section 501(c)(3) and to the Exempt Organizations Handbook issued by the National Office's Technical staff; and (3) the Audit Technique Guidelines discussed at pages 2601-02 above. These Audit Technique Guidelines include 34 pages relating to 501(c)(3) organizations, focusing primarily on whether the organizational and operational tests for exemption qualification continue to be met, with particular emphasis on private inurement and legislative or political activities, and whether any taxes are due from the organization (unrelated business income, employee withholding and chapter 42 excise taxes) or from individuals (for example, "Determine whether any assets are being used for personal purposes. This may be income to the user").

With regard to charitable fund-raising activities, the Audit Technique Guidelines observe that, "Professional fund-raisers usually get a percentage of the gross depending on their experience and ability," without advising that this practice is unanimously condemned and prohibited by the ethical standards of the American Association of Fund-Raising Counsel, the National Society of Fund Raisers, the National Information Bureau, and the Council of Better Business Bureaus.[156]

The examinations training course also includes eight case problems, of which two concern 501(c)(3) organizations both based on data from hypothetical audits of 1970 returns. One involves an organization promoting open occupancy housing and the other involves a hospital.

Subjective opinions expressed informally both by Service personnel and by experienced private attorneys have tended to be critical of the qualifications and training of the Service's exempt organization field staff. In a survey of 2,247 private foundations conducted by the Council on Foundations in March 1974, 78 of the 489 respondents on the question reported that agents auditing them did not seem knowledgeable in foundation law and practice.[157] (The very recent introduction of tax-law specialists into the field staff, under the new Assistant Commissioner for Employee Plans and Exempt Organizations, should produce improvement; see pages 2623 and 2630 below.)

Incidence and Results of Exempt Organization Audits

Incidence

Since 1969 the Service has audited more than three times as many private foundations as public charities, and twice as many 501(c)(3) organizations as all other categories of exempt organizations combined. Indeed, this emphasis so increased over the period 1969-1973 that in FY 1973, private foundation audits accounted for 88 percent of all 501(c)(3) audits and for 79 percent of all exempt organization audits. (To place this emphasis in perspective, private foundations constituted less than 12 percent of all active 501(c)(3) organizations in FY 1973 and less than 4 percent of all exempt organizations known to the Service; thus, about two thirds of the private foundations and about 2.9 percent of all exempt organizations were audited in FY 1973.) The following data were supplied by the Service:

Exempt Organization Audits Completed

	FY 1969	FY 1970[a]	FY 1971	FY 1972	FY 1973	Total FY 69-73
Private foundations	2,896	2,830	3,303	7,804	14,958	31,791
Other 501(c)(3) organizations (public charities)	1,118	1,724	2,007	3,116	2,046	10,011
Subtotal	4,014	4,554	5,310	10,920	17,004	41,802
Other exempt organizations	4,504	3,989	3,683	5,379	1,976	19,531
Total	8,518	8,543	8,993	16,299	18,980	61,333

a. Figure for FY 1970 is years (returns) rather than cases (entities).

During FY 1974 the Service had budgeted, for private foundation audits, 63.9 percent of the total man-hours to be devoted to the exempt organization examination program.[158] Apparently, however, with the fulfillment in December 1974 of the Service's 1969 commitment to Congress to audit all foundations within five years, greater attention to other exempt organizations may now be expected. At least for the near term this is reflected in the Service's selection of exempt organizations to be included in the Taxpayer Compliance Measurement Program (TCMP), in which the Service analyzes data from special and unusually thorough audits conducted on a scientifically selected sample basis to evaluate taxpayer compliance characteristics.

Although long utilized by the Service in the income tax area, the TCMP program has not previously been applied to exempt organization returns. It is now being applied to 11,500 of the exempt organization returns filed during the 18-month period that commenced August 1974. These include returns of 3,500 private foundations (other than those on the NOCC list), 3,500 public charities and 3,500 organizations exempt under section 501(c)(4)—each selected to provide stratified samples based on asset and income range. The Service expects data from the TCMP-Exempt Organization program to identify tax administration gaps in formulating the Service's long-term enforcement policies and to lead to improved selection of returns for audit, identify alternative methods of operation, and achieve greater operating economies.[159]

Results

The results of the exempt organization audit program cannot be measured in statistical terms alone. The fact that there is a program is itself a powerful incentive for exempt organizations to keep their houses in order. But since the audit program is intended to disclose whether exempt status has been maintained and whether taxes are due, it can be assessed preliminarily, at least, in terms of exemption revocations and tax collections. If the available information on 501(c)(3) and other final revocations (see page 2602 above) are related to the comparable data shown above on completed audits, the results are as follows:

	FY 1972		FY 1973		Total FY 72-73	
	Audits Completed	Final Revocations	Audits Completed	Final Revocations	Audits Completed	Final Revocations
All 501(c)(3) organizations	10,920	78	17,004	117	27,924	195
All other exempt organizations	5,379	256	1,976	233	7,355	489

Not all revocations become final in the same fiscal year in which the audit is completed, but the totals for 1972 and 1973 suggest that revocation of exempt status results from less than 1 percent of 501(c)(3) organization audits and from about 6 percent of audits of other exempt organizations.

Data furnished by the Service shows that about $7 million of net tax deficiencies were assessed in the returns of public charities, and about $1.2 million in those of private foundations, for the year 1970 through 1972. Net tax deficiencies for private foundations and public charities for the years 1970 through 1973 are as follows:

	No. Audits Completed	Net Tax Deficiencies Assessed No.	Net Tax Deficiencies Assessed Amount
FY 1970			
Private foundations	2,830	56	$ 455,149
Other 501(c)(3) Organizations	1,724	47	1,225,893
FY 1971			
Private foundations	3,993	124	403,150
Other 501(c)(3) Organizations	2,007	89	2,455,151
FY 1972			
Private foundations	7,894	139	359,277
Other 501(c)(3) Organizations	3,116	161	3,309,399
FY 1973			
Private foundations	14,958	635	9,509,359[a]
Other 501(c)(3) Organizations	2,046	326	1,771,066

[a] We are advised by the Service that this figure includes a limited number of highly unusual cases of a nonrecurring nature, including a multiplier effect of first level, second level and penalty taxes, and that the figure is therefore distorted in relation to the figures for prior years. Published reports indicate that one case alone involved jeopardy assessment of such penalties multiplied to $2.6 million. Note also that these figures represent assessments, not collections.

It seems clear that the concentration of audits on private foundations has not led to substantial penalty tax collections under the chapter 42 provisions. Only $749,000 of such penalty taxes have been collected through June 30, 1974, although more than 26,000 private foundation audits were completed during FY 1971-1973:

Private Foundation Penalty Tax Collections[a]
(in thousands of dollars)

	FY 1971	FY 1972	FY 1973	FY 1974	Total
Sec. 4941 Self-dealing	$ 8	$ 45	$ 78	$229	$360
Sec. 4942 Failure to distribute income	-	-	94	160	254
Sec. 4943 Excess business holdings	27	51	13	3	94
Sec. 4944 Investments jeopardizing charitable purposes	-	-	16	8	24
Sec. 4945 Taxable expenditures	1	7	1	8	17
Total	$36	$103	$202	$408	$749

[a] These figures do not take account of assessments not collected, including the 1973 assessment discussed in the note to the preceding table. For the reasons explained in that note, we do not believe that the 1973 assessment will affect the trend of the figures discussed above. 1974 data are from News Release IR-1453, December 9, 1974, all other data from Annual Reports of the Commissioner through FY 1973.

The foregoing data indicate plainly that by the Service's traditional audit criteria, the concentrated focus on auditing private foundations has not been rewarding. However, the Service itself recognizes that traditional cost-benefit measurements are inappropriate for exempt organization matters. Official policy in this respect was stated as follows in a 1972 Treasury Department memorandum that was formally endorsed by the Commissioner and incorporated generally in instructions to the Service's field staff:[160]

> These private foundation provisions must be interpreted and administered in light of their special purpose and their individual structure as a group in the Code. Their purpose is not to raise revenue; they are designed to act as a guardian to insure that foundation assets will be put to charitable uses. In interpreting and administering these provisions, a strict adversary position should not automatically be taken. They call for an extraordinary degree of care and judgment in their application. We should not assume that private foundations are subject to a presumption of impropriety in their dealings or that it is the role of the Treasury Department to discourage their existence.
>
> Sanctions should be imposed only where appropriate, and every effort should be made to carry out the Congressional intent to benefit, rather than impede, charity. Each factual situation must be examined on its own merits and a threshold decision made whether it violates the basic intent and spirit of the provisions. If it does not, then the purportedly charitable activity should be allowed to continue, and we should not attempt to proscribe such activity by creating formalistic, unworkable, or unreasonable rules, through strained interpretations of the Code provisions.[161]

Apart from revenue considerations, and whether or not justified by the Service's 1969 commitment to Congress, the concentration of the Service's exempt organization audit program on private foundations has been accompanied by a concomitant neglect of public charities. We discuss at pages 2644-47 and 2661-62 below some of the byproducts of this relative neglect of public charities.

Independence and Objectivity

The programs of philanthropic organizations are diverse; they reflect priorities that range across a wide economic and political spectrum. It is the very diversity assured by private decision making that constitutes the public's protection against use of philanthropic funds to imbalance the social dialogue. The maintenance of this diversity gives a constitutional dimension to the determination of 501(c)(3) status, which for practical purposes is a license to operate:

> The tax laws relating to charities are unique in their impact on First Amendment activity. In practice, exercise of the right of association to advance common interests frequently depends on qualification of the association for section 501(c)(3) exemption. Moreover, speech and speech-related activities are a primary means—and often the only means—whereby the "religious," "charitable," and "educational" purposes specified in the statute can be advanced. The Revenue Service, whose task it is in the first instance to interpret and apply the statutory classifications, is continually charged with the delicate task of determining whether particular forms of First Amendment activities qualify for the statutory benefits.[162]

It is therefore essential that government oversight of philanthropy be non-partisan, objective, and non-ideological. We turn now to an examination of the Internal Revenue Service's record in this respect and some factors that appear pertinent in shaping that record.

The Service's Record

The 1952 reorganization of the Service was prompted largely by the scandals of the Truman administration.[163] One result of the scandals was a hypersensitivity to political influence among the employees who survived the Service's thorough housecleaning.[164]

Pride in nonpartisan professionalism, enhanced by placing all Service positions under career civil service except for the Commissioner himself,[165] thus became an organizational tradition and an important part of the Service's institutional character. "The IRS has spent the last 22 years—since its reorganization was approved by Congress—trying to ensure a non-political, non-partisan, career service approach to tax administration. . . ."[166] This objectively professional approach was formulated into a "Statement of Principles of Internal Revenue Tax Administration" which was formally issued as a Revenue Procedure in 1964[167] and is republished in each issue of the Internal Revenue Bulletin:

> The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.
>
> With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.
>
> At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.
>
> The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.
>
> Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

In judging how well the Service adheres to these principles, we look first to its record prior to 1969 in applying the restrictions of section 501(c)(3) concerning legislative and political activities of exempt organizations, and then to the results of recent congressional investigations into attempted misuse of the Service for political and ideological purposes since that time.

Political activities cases prior to 1969. Any organization is disqualified for 501(c)(3) status if a "substantial" part of its activities consists of "propaganda, or otherwise attempting, to influence legislation," or if it participates in an election "on behalf of any candidate."[168] Regardless of the merits of these restrictions (which are considered by another study undertaken for this Commission),[169] and of the similar restrictions imposed on private foundations by the Tax Reform Act of 1969 without regard to whether the proscribed activity is substantial,[170] it is apparent that the statutory language is susceptible of wide latitude in interpretation.[171] Since 1934 when this language first became part of the Internal Revenue Code, the Service's administration of these provisions seems to have fluctuated—in some periods more strict, in others more relaxed. But whether right or wrong on the legal issues involved (such as whether an organization may be disqualified merely for having objectives whose ultimate achievement would require legislation),[172] the Service's handling of such cases does not appear to have reflected any particular partisan or ideological bias, with relatively few exceptions.[173]

A principal exception seems to have been the Service's treatment of "subversive" organizations during the height of the Cold War. On February 4, 1948, the Commissioner announced: "The tax laws do not contemplate and it has never been our policy to grant tax exemption or other tax privileges to subversive organizations." A year earlier the Service had begun summary revocations of exempt organizations on the Attorney General's List. During 1947 and 1948 alone, 35 such revocation rulings were issued. Some of the affected organizations had been recognized as exempt for over 15 years; one had received a favorable ruling only 6 months before its revocation.[174] At no time was the term "subversive" defined by any Revenue Ruling, Revenue Procedure, or Treasury Regulation.[175] Instead the Service relied upon its unilateral determination that a "subversive" (undefined) organization could not be "educational."[176]

In 1955 the Service revoked the exemption of the Institute of Pacific Relations on the ground that it was engaged in disseminating partisan propaganda. When subsequently challenged in court, the Service's only supporting evidence was a report and hearings of the Senate Internal Security Subcommittee, which had been transmitted to the Service by Senator McCarran with the request that the Service reconsider the institute's exempt status. The federal court found that the institute had neither disseminated propaganda nor attempted to influence any governmental policies or actions, and that the revocation was unjustified.[177]

The Service's performance in these Cold War "subversive" cases seems to have reflected the political climate of the period. Under the circumstances of the time, however, the Service was not less objective than other federal agencies, state and local governments, many private institutions, and much of the public at large. The Service's posture on political ideologies at the close of that period may have been best described by Elias Clark in 1960:

> The factors which have shaped the political activities restriction come into focus when the problem is viewed from the perspective of the Treasury. To the collector of the taxes and the guardian of the tax law, political theorizing is irrelevant. It is concerned on two counts with tax support of controversial issues. First, it does not want the unenviable task of selecting those political purposes which are compatible with charitable principles and rejecting those which are not. Within the last decade two congressional committees [the Reece Committee and the Cox Committee] have demonstrated particular interest in the political outlook of tax-free charities. Understandably, there is no desire to provoke the sleeping lion once again. Secondly, the Treasury must replace those tax losses resulting from deductions out of other taxes without destroying public confidence in the system. It is obviously difficult to justify a tax subsidy for a political purpose with which a considerable segment of the population is out of sympathy.[178]

There are indications that during the 1960s the Service occasionally cut corners at the behest of the White House.[179] The Service was reportedly asked by the White House in 1961 to investigate far-right hate groups that were tax exempt.[180]

It may not be coincidence that in April 1962 the Service commenced an audit of Christian Echoes National Ministry, Inc., a 501(c)(3) organization headed by the Rev. Dr. Billy James Hargis, which had attacked President Kennedy and endorsed conservative candidates in 1961. Although the resulting revocation was eventually upheld by the court of appeals,[181] a federal district court first found that the Service's decision to revoke was made by the National Office before sufficient evidence had been accumulated, without formal legal advice from the Chief Counsel's office, and was arbitrary, discriminatory, and a denial of due process.[182] In reversing the district court, the court of appeals on this point held only that Christian Echoes had not "shown any prejudice by [the Service's] deviation from normal procedures" and that the Service's failure to proceed against other similar organizations did not amount to a denial of due process.[183]

1969 to present. Three recent congressional investigations into attempted misuse of the Service for political and ideological purposes provide a basis for judging how well the Service has maintained nonpartisan professionalism since 1969.

In 1973 the staff of the Joint Committee on Internal Revenue Taxation investigated charges that the White House had used the Service's audit procedures for partisan political purposes during the period 1969-1972. The charges related to treatment of exempt organizations as well as individual taxpayers, but thus far the committee staff has reported only on its investigation into the alleged harassment of individuals. That report, issued December 20, 1973, after examination of the Service's files on over 700 individuals whose names appeared on various White House lists of political opponents, found no evidence that the Service screened any returns as a result of White House pressure, no evidence that audits of people on those lists were on the average conducted more harshly than normal, and no evidence that particular individuals were treated in a different manner from taxpayers generally.[184]

The alleged harassment of exempt organizations related to a Special Service Staff (SSS) established in 1969 as a result of inquiries made of the Service by the Permanent Subcommittee on Investigations of the Senate Committee on Government Operations. The Joint Committee staff found that the function of the SSS was to "gather information on the finances and activities of extremist organizations . . . and make this information, along with recommendations on what to do with it, available to the appropriate division of the IRS . . . The SSS did not engage in . . . Its recommendations were rather that a certain tax return should be examined by the Audit Division." By June 1972 the SSS had information files on 2,500 organizations.[185]

While the Joint Committee staff has not yet reported on its investigation of the SSS,[186] information on this subject from other congressional inquiries indicates that the Service did not produce the partisan results apparently sought by the White House. Documents made public by the Impeachment Inquiry of the House Judiciary Committee and by the Senate Subcommittee on Constitutional Rights include an internal White House memo dated September 21, 1970, transmitting a report on the activities of the "Special Service Group" and observing: "Nearly 18 months ago, the President indicated a desire for IRS to move against leftist organizations taking advantage of tax shelters. I have been pressing IRS since that time to no avail."[187] The accompanying status report from Commissioner Thrower showed that of the 1,025 organizations on which the SSS had then collected information, 26 had been referred to the field for audits, and 8 applications for exempt status had been denied. The Commissioner's report emphasized that "only information relating to tax status" was recorded and disseminated to field offices and that the "sole objective" of the SSS was "to provide a greater degree of assurance of maximum compliance with the Internal Revenue laws by those involved in extremist activities and those providing financial support to these activities." He noted that in the view of Service officials the SSS's activity and field enforcement "is necessary to avoid allegation that extremist organizations ignore taxing statutes with immunity."[188]

More than a year later, a White House memorandum prepared for use at a meeting with the Secretary of the Treasury concerning White House efforts to "make IRS politically responsive" stated: "We have been unable to crack down on the multitude of tax exempt foundations that feed left wing political causes," and that "[p]ractically every effort to proceed in sensitive areas is met with resistance, delay and the threat of derogatory exposure." The administration's successive appointees as Commissioner were respectively described in the memorandum as "actively fighting both Treasury and the White House" and "oversensitive in his concern that IRS might be labeled 'political' if he moves in sensitive areas (e.g., audits, tax exemptions)."[189] Other documents made public by the Impeachment Inquiry indicate that Commissioners Thrower and Walters responded to such White House pressures by threatening to resign and expressing concern to the Attorney General.[190]

The December 1974 staff report of the Senate Subcommittee on Constitutional Rights amplifies considerably the Impeachment Inquiry's evidence concerning the Special Service Staff.[191] With regard to exempt organizations, the SSS was to recommend to local district Audit Divisions an audit if information collected by the SSS (largely from other federal agencies, newspapers and militant publications) indicated that the organization was engaged in activities inconsistent with its tax-exempt status.[192] Prior to 1972, district-level Service employees "tended not to take Special Service Staff referrals seriously," treating them as "courtesy investigations."[193] In early 1972 the Service shifted the primary interest of the SSS away from "dissident, activist and extremist" groups generally to refocus specifically upon groups and individuals "actively urging noncompliance with the tax laws";[194] thereafter SSS referrals to the field were treated more seriously.[195]

During the three years ended June 30, 1972, only 182 individual or organizational cases out of the then 9,800 SSS files had been referred to the field, of which 79 were still pending. The number of exempt organizations among the 103 completed cases is not identified, but the consequences in those 103 cases included one exempt status revocation and 124 delinquent tax returns secured. By a year later, just before the SSS was disbanded by Commissioner Alexander, the total field referrals by the SSS since its 1969 inception amounted to 554, of which 320 were "identified tax resisters," and the consequences included three exempt status revocations and 203 delinquent returns secured.[196]

The other principal function of the SSS affecting exempt organization was to review cases referred to it by the Exempt Organizations Branch (Technical) in which a ruling or technical advice was pending involving "ideological, militant, subversive, or radical elements." In such cases the SSS was to furnish the Branch with any available information from SSS files, to "minimize the possibility of issuing erroneous advice or rulings due to lack of information." As of June 30, 1973, the SSS had reviewed a total of 146 such cases referred by the Branch; 29 received unfavorable rulings, 32 received favorable rulings, the SSS had no interest in 59, and 26 were still pending. The Constitutional Rights Subcommittee Staff was unable to ascertain whether and how often SSS review actually prevented the issuance of a favorable exemption ruling but noted that the delay occasioned by the SSS review "could stifle an organization before it really got started."[197]

Commissioner Alexander disbanded the Special Service Staff in 1973, explaining that he had found it to be unnecessary but that the IRS will "continue to pay close attention to tax rebels – tax resistance organizations and those individuals who publicly advocate noncompliance with the tax laws – but political or social views, 'extremist' or otherwise, are irrelevant to taxation."[198]

Relevant Organizational Factors

The foregoing review indicates that the Service has not been totally immune to improper political or partisan influences[199] but that on the whole its resistance to such influences – even from the White House – seems to be unusually strong. Perfection cannot realistically be expected of any government agency in the face of powerful congressional or White House pressures. However, apart from the aberrations of the early Cold War era which affected the Service equally with the rest of the nation, the instances in which the Service may fairly be regarded as having succumbed to partisan or ideological bias appear to be few. Moreover, the Service's pride in the public evidence from the Watergate-related investigations that successive Commissioners adhered to the tradition of nonpartisan objectivity despite strong contrary pressures, can only have reinforced the institutional strength of that tradition. One critical observer of the Service's performance commented that in resisting White House moves to tighten control, "no agency gave the palace guard a harder time than the I.R.S.," and concluded: "Except for a few singular and spectacular breaches, the campaign to politicize the I.R.S. foundered on principled commissioners and a stubbornly independent bureaucracy – to be sure, a bureaucracy capable of its own excesses, but one that served, basically for reasons of its own self-interest, as a sort of latter-day check and balance the Founding Fathers didn't think of.[200]

Certain organizational features of the Internal Revenue Service seem to contribute to its relative unsusceptibility to partisan influences. (Some of these features may, from another viewpoint, be seen as weaknesses.)

First, the Service is a large bureaucracy preoccupied with collecting money rather than with ideological concerns, and deliberately decentralized to minimize political influence. The dichotomy between administrative line authority in the field and functional staff authority in Washington may not be analytically neat, but it increases the difficulty of making political influence in Washington felt at the operating level in the field. The fact that all of the Service's field personnel (including District Directors) and virtually all of its National Office personnel are career civil servants also militates against effective partisan influence.

Second, the Service's complex internal procedures and numerous levels of review provide checks and balances that impede partisan intervention in any particular case. As the Commissioner recently observed, ". . . . our procedures, which involve frequent reviews and a diffusion of managerial authority, almost defy abuse."[201] (Unfortunately, they also lead frequently to substantial delay.)

The same point was stated in less bureaucratic terms by a journalist who recently examined the Service's response to improper political pressure: "Given its size and cumbersome procedures, IRS is not necessarily galvanized by an event like a telephone call from the White House."[202] One lawyer with a large IRS practice was quoted by that journalist as remarking: "Lots of us have complained over the years about how glacially IRS moves, and the number of people and the absurdity of its procedures – requiring so many tiers of approval, for example. Well, I still think IRS is cumbersome. But had it been any other way, the Nixon people well might have succeeded. That is the virtue of a bureaucracy."

Third, while difficult to measure, the vocational backgrounds and training of Service personnel probably reinforce to some extent the Service's official indifference to ideological questions.

Two additional factors, arising out of the fact that exempt organization matters comprise only a minor part of the Service's responsibilities, seem pertinent as well. Since the Service is widely perceived as a cumbersome but non-ideological bureaucracy, not much attention is given by the general public to specific decisions in the exempt organization area,[203] even though such decisions often are politically sensitive. This might not be the case if exempt organization matters were regulated in a more prominent or isolated fashion.

Furthermore, the one Service official who is polticially appointed – the Commissioner – is not likely to be chosen for reasons which give much weight to his ideological views on exempt organizations.

Coordination with State Authorities

Code section 6104(c), adopted in 1969, requires the Service to:

> (A) notify the appropriate State officer of a refusal to recognize such organization as an organization described in section 501(c)(3), or of the operation of such organization in a manner which does not meet, or no longer meets, the requirements of its exemption,
>
> (B) notify the appropriate State officer of the mailing of a notice of deficiency of tax imposed under section 507 or chapter 42, and
>
> (C) at the request of such appropriate State officer, make available for inspection and copying such returns, filed statements, records, reports, and other information, relating to a determination under subparagraph (A) or (B) as are relevant to any determination under State law.
>
> (2) APPROPRIATE STATE OFFICER. – For purposes of this subsection, the term "appropriate State officer" means the State attorney general, State tax officer, or any State official charged with overseeing organizations of the type described in section 501(c)(3).

The Service has read section 6104(c) narrowly, insisting that only after a final Service determination denying or revoking 501(c)(3) status, after all administrative reviews have been completed, is the state entitled to notice under 6104(c)(1)(A).[204] Similarly, in chapter 42 excise tax cases or section 507 termination tax cases, notice to State Attorneys General is given only upon issuance of a 90-day letter (if the tax is disputed) or upon acceptance by the key district review staff of a signed waiver of restrictions on assessment and collection (if the tax is agreed to).[205] Since it can take years for an audit and review by the Service to reach these stages of finality, some state officials have complained that the Service's failure to share information sooner requires expensive duplication of effort, and further that the Service has provided only limited information in response to state requests even after such final determination.[206] As of April 4, 1973, the Service had sent a total of 3,069 notices to state officials under section 6104(c).[207]

Evidently as a result of complaints by state officials, the Service modified its instructions in 1973 to field examination personnel to allow early notification to state authorities "in special situations where notice to State officers in advance of an issuance of a final determination seems appropriate," provided approval by the National Office Audit Division is first obtained. However, since the new instruction is explained as reflecting "the regulatory nature of the provisions of Chapter 42," it would appear applicable only in private foundation cases.[208]

In addition to section 6104(c), Congress adopted three other measures in 1969 to improve coordination between the Service and state authorities, all relating to private foundations.

First, section 508(e) denies exempt status to private foundations whose charters do not include provisions prohibiting the organization from carrying on activities which would subject it to penalty taxes under sections 4941-4945. This provision, in effect giving the states parallel enforcement rights to compel observance of such charter restrictions, was requested by the National Association of Attorneys General.

Second, section 6056(d)(3) requires that state officials be furnished copies of the annual reports of private foundations.

Third, section 507(g) provides for abatement of the private foundation termination tax if state officials, after notice that the Service has issued a deficiency notice for the tax, initial corrective action under state law and thereafter certify to the Commissioner that such action has resulted in preservation of the foundation's assets for charitable purposes. (The private foundation termination tax, equal to the aggregate tax benefits of exempt status or the foundation's total net asset value, is imposed by section 507 in cases of wilful and repeated or flagrant violations of chapter 42.)

Improved coordination by the Service with state authorities may require further changes in the Service's administrative practices or amendment of section 6104(c). It is, however, not clear that states are presently making the most use of the information that is available. In 1973 the Service increased the number of section 6104(c) notices to state authorities to more than 7,800; only three states exercised their right to request inspection of the Service's material, in 118 cases.[209]

III

EFFECT OF THE NEW ASSISTANT COMMISSIONER

The Internal Revenue Service is presently reorganizing in the exempt organization area as a result of amendments to the Internal Revenue Code contained in the Employee Retirement Income Security Act of 1974, effective December 2, 1974. The basic amendment is the establishment of a new Office of Employee Plans and Exempt Organizations, headed by an Assistant Commissioner, with responsibility for exempt organization matters and for employee pension and profit-sharing plans. At the National Office level, both the Exempt Organizations Branch (Technical) and the Exempt Organization Examination Branch (Audit) described in Chapter II above have just recently been transferred to the new Assistant Commissioner's office; other changes are now being made at the district and regional levels.

This reorganization gives the Service a special opportunity to improve the procedures for dealing with charitable organizations, to reduce delays in processing, to upgrade the caliber of the personnel in this area, and generally to remedy existing problems. We review here the organizational changes in prospect and, to the extent possible at this early stage, the potential effect of such changes on how the Service deals with exempt organizations.

The Statutory Changes

The 1974 amendments, although relating primarily to pension and profit-sharing plans, include exempt organizations in a statutory reorganization of the Service's administration of tax exempt matters. Under new Code section 7802(b):

> There is established within the Internal Revenue Service an office to be known as the "Office of Employee Plans and Exempt Organizations" to be under the supervision and direction of an Assistant Commissioner of Internal Revenue. As head of the Office, the Assistant Commissioner shall be responsible for carrying out such functions as the Secretary [of the Treasury] or his delegate [the Commissioner] may prescribe with respect to organizations exempt from tax under section 501(a) and with respect to [pension and profit-sharing plans] . . .[210]

In addition to its statutory establishment, the Office of Employee Plans and Exempt Organizations, unlike any other part of the Service, has its own appropriations authorization, established permanently at a level equal to the revenues from the private foundation investment income tax (Code section 4940) if the rate of such tax was 2 percent plus an amount equal to that 2 percent figure or $30 million, whichever is larger.[211] The Service currently budgets about $20 million for exempt organizations and $40 million for employee plans. At recent levels of section 4940 collections, the new formula will *authorize* approximately the same amount of money, although presumably the Service is to have at least some increased responsibilities. In any case, the authorization limit has practical significance only if the executive branch seeks actual *appropriation* of the full amount so authorized. At the present time, there are indications that projected funding for the new office is being routinely included in the executive branch's total budget request for the Service, without regard to the separate authorization, and that the funding so projected is below the authorized level.

The authorization formula is unlikely to produce sufficient funds for the new office. More serious, the formula is, we believe, conceptually deficient. The section 4940 tax on private foundations was intended to defray the cost of enforcing chapter 42 and auditing private foundations; there was thus a nexus between the tax and the activities it was supposed to finance.[212] As a partial measuring rod of the cost of dealing with all exempt organizations and employee plans, however, the tax makes no sense. Moreover, revenues raised by the section 4940 tax may be affected by general economic factors bearing no relationship to the appropriate level of funding for the new office.[213] It seems to us preferable, in lieu of the section 4940 tax, to impose a modest fee on employee plans and on a larger portion of the 501(c)(3) universe to provide adequate funding for the new office, equitably borne by the majority of organizations subject to it.

The legislative history, to which the Service can be expected to pay close attention in implementing these provisions, amplifies the purpose and the intended authority of the new Assistant Commissioner's office. Both the Ways and Means Committee and the Senate Finance Committee stated:

> Concern has been expressed in the case of the administration of employee benefit plans (and also tax exempt organizations) as to whether the Internal Revenue Service with its primary concern with the collection of revenues is giving sufficient consideration to the purposes for which these organizations are exempt. Many believe that the present organization of the Service causes it to subordinate *concern for the protection of the interests of the plan participants (or the educational, charitable, etc., purposes for which the exemptions are provided)* . . .
>
> . . . it must be recognized that the natural tendency is for the Service to emphasize those areas that produce revenue rather than those areas *primarily concerned with maintaining the integrity and carrying out the purposes of exemption provisions.* Similar concern has been expressed in the past over the Service's administration of the provisions of the tax law relating to exempt organizations.
>
> The committee believes that in the employee benefit plan and tax exempt organization area it should be easier to *emphasize the basic objectives involved* if the activities relating to these plans and exempt organizations were more closely coordinated, *if the activities in these areas relating to auditing, rulings, etc. whether in the field or in the national office are brought together and if the top direction for these activities also has specialized in them.* For the reasons outlined, the bill establishes a separate office in the Internal Revenue Service, headed by an Assistant Commissioner for Employee Plans and Exempt Organizations to deal primarily with plans that are (or claim to be)

> qualified under section 401 of the code and organizations that are (or claim to be) exempt from income taxes under section 501(a) of the code. This includes pension, profit-sharing and stock bonus trusts and plans, religious, educational, and charitable organizations and foundations as well as the various other exempt organizations described in section 501(c) of the code. *Similar units are to be established in the various regional and [Ways and Means Committee says "and/or"] district offices . . .*
>
> In connection with organizations exempt from tax (under sec. 501(a) of the code) *it is intended that this office have the responsibilities as to an organization's exempt qualification, the taxes on unrelated business income of an organization exempt from tax, and the rules relating to the private foundation provisions of the Internal Revenue Code.*
>
> To carry out the provisions of this bill, it is intended that the principal activities referred to above will be transferred from the various Assistant Commissioners' offices to the new Office of the Assistant Commissioner (Employee Plans and Exempt Organizations). With these transfers it is intended that *the Assistant Commissioner (Employee Plans and Exempt Organizations), under the direction and supervision of the Secretary, or his delegate, will have the authority to direct national and field office policy in connection with the basic activities of the Service relating to employee plans and exempt organizations.*[214]

The statutory amendment thus creates for the first time a high official within the Service whose principal function is not tax collection. The new Assistant Commissioner is clearly charged with carrying out the congressionally enacted public policy with regard to the management of what are basically trust funds, of both employee benefit and charitable varieties. The bifurcation of exempt organization administration between the Assistant Commissioners for Compliance and for Technical matters is to be eliminated; all these activities are to be under the new Assistant Commissioner who will have authority to direct both "national and field office policy in connection with the basic activities of the Service relating to . . . exempt organizations." Although he will be a career officer subject to the direction and supervision of the Commissioner, this new official is to hold the only assistant commissionership expressly created by statute and head the only Service office having its own statutory budget authorization.

Effect on the Organizational Structure of Exempt Organization Administration

The basic organizational changes resulting from the new statutory provision already seem fairly clear, although it is still too early to judge their effects. By amendments to the Internal Revenue Manual issued February 19, 1975,[215] the Commissioner implemented structural changes planned by a Service task force that had been at work for several months after enactment of the new law first appeared imminent. We summarize below the changes that are already definite, others that may also be under consideration, and their likely implications.

National Level

The office headed by the new Assistant Commissioner includes three divisions: an Exempt Organizations Division, an Employee Plans Division, and an Actuarial Division (the latter two concerned with pension and profit-sharing matters). The

Exempt Organizations Division has a Technical Branch performing the functions heretofore performed by the Exempt Organizations Branch of the Miscellaneous and Special Provisions Tax Division under the Assistant Commissioner (Technical), and an Operations Branch performing the functions heretofore performed by the Exempt Organization Examination Branch of the Audit Division under the Assistant Commissioner (Compliance). See the organizational charts reprinted at pages 2624-25 below. Both new Branches are staffed largely by employees transferred from the respective predecessor branches, which have been moved virtually intact to the new Exempt Organizations Division.[216]

Thus, all exempt organization status determinations, rulings and technical advice, and all compliance functions and prescription of uses to be made of the Exempt Organization Master File, have [illegible] been brought together in a single Division under the new Assistant Commissioner.

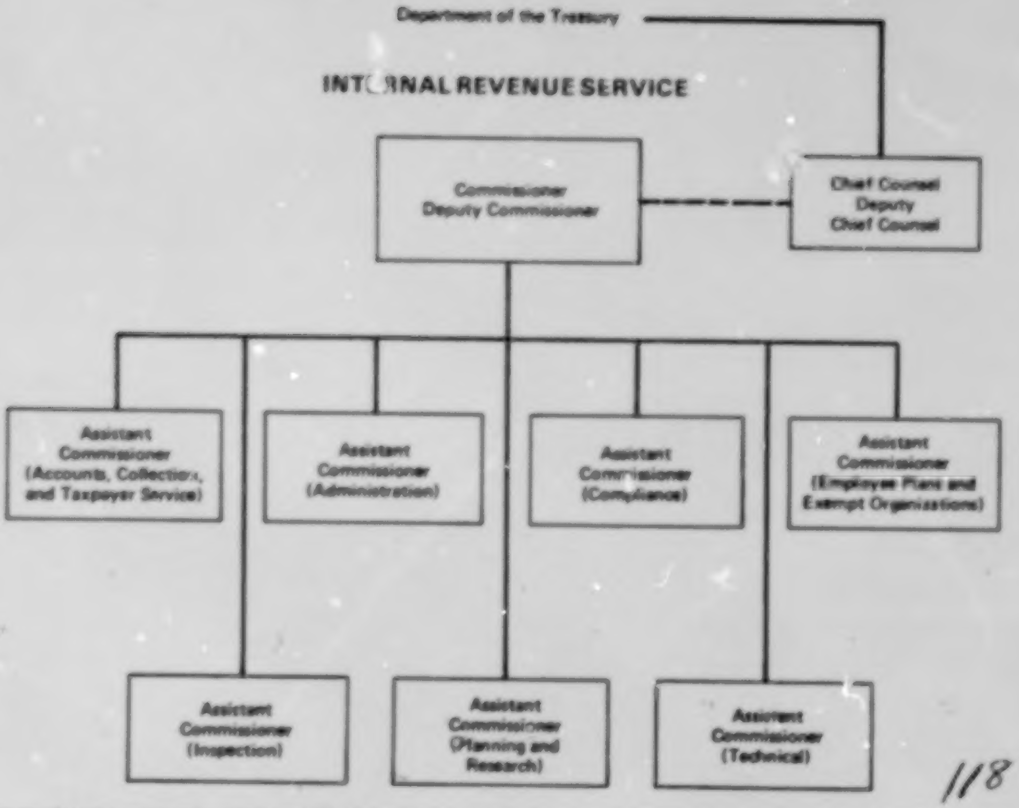
Compliance Functions. Combining compliance functions and EOMF supervision under the office that is also responsible for technical questions should help to strengthen the expertise of exempt organization audit personnel and focus the audit program on non-revenue objectives. Under the direction of a single Assistant Commissioner, the training programs of field personnel and technical personnel can be better coordinated and improved. Greater concern for and sensitivity to the substantive objectives of the audit program should also result from combining supervision of compliance and technical functions in one division of the National Office.

A significant step in these directions has already been taken by the decision to introduce tax-law specialists, previously assigned only to the National Office under the Assistant Commissioner (Technical), into the exempt organization field staff (see page 2630 below).

Some consideration has been given to the advisability of dividing the new Operations Branch, which will supervise field examination activities, into separate sections for audits of private foundations and audits of public charities and other exempt organizations. This would depart somewhat from the Service's typical structure in which organizational units are identified by administrative function rather than by program relationship, but the distinct and complex requirements and excise taxes applicable to private foundations seems to justify such separate sections. The result should be improved supervision of private foundation audit activities and greater attention to audit matters unique to public charities, such as fund-raising practices. Apparently no final decision has yet been made on whether to adopt this structure.

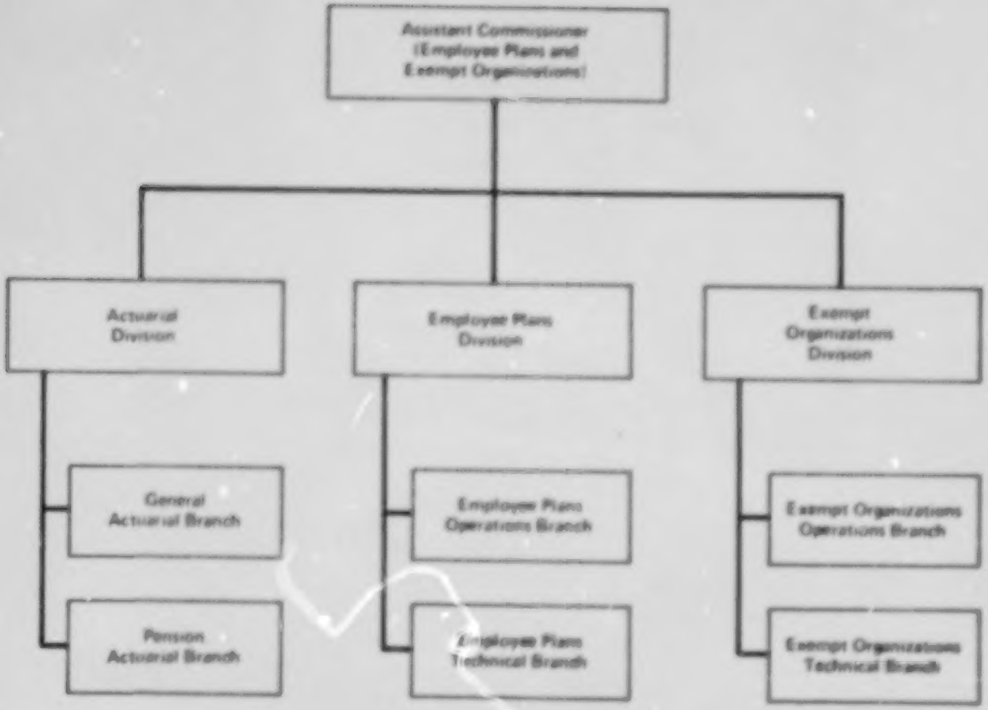
Rulings procedures. Authority to issue rulings and technical advice, and to approve relief from retroactivity in revocation cases, has been transferred to the new Assistant Commissioner from the Assistant Commissioner (Technical) with respect to exempt organization and pension matters. This may make it easier to adapt the Service's advance rulings policy in exempt organization cases to the particular interests and needs of philanthropy, for example in ruling on proposed transactions involving questions of fact (see pages 2603-04 above), although major departures from the Service's overall rulings policy are unlikely.

It is not yet clear whether the new Assistant Commissioner's ruling authority will make it easier or more difficult to resolve intra-Service differences over interpretation of exempt organization Code provisions that are interrelated with other provisions of the Code, such as sections 4945 and 117 concerning scholarship and fellowship grants to individuals (see page 2603 above). It was difficult to reconcile differences of approach when the branches responsible for technical interpretation of such related provisions were both under the Assistant Commissioner (Technical). It may be even more difficult now that exempt organization rulings are under the


Department of the Treasury
INTERNAL REVENUE SERVICE
Commissioner
Deputy Commissioner
Chief Counsel
Deputy
Chief Counsel
Assistant Commissioner (Accounts, Collection, and Taxpayer Service)
Assistant Commissioner (Administration)
Assistant Commissioner (Compliance)
Assistant Commissioner (Employee Plans and Exempt Organizations)
Assistant Commissioner (Inspection)
Assistant Commissioner (Planning and Research)
Assistant Commissioner (Technical)

118

Organization of the Office of Assistant Commissioner (Employee Plans and Exempt Organizations)


Assistant Commissioner (Employee Plans and Exempt Organizations)
Actuarial Division
Employee Plans Division
Exempt Organizations Division
General Actuarial Branch
Pension Actuarial Branch
Employee Plans Operations Branch
Employee Plans Technical Branch
Exempt Organizations Operations Branch
Exempt Organizations Technical Branch

new Assistant Commissioner while rulings of the Individual Income Tax Branch remain under the Assistant Commissioner (Technical).

In anticipation of the improved technical expertise likely to result from assignment of tax-law specialists to key district and regional offices, the absolute right of organizations to have unfavorable exemption determinatons reviewed by the National Office is apparently now to be eliminated. Instead, the right of appeal from denials, revocations and modifications of 501(c)(3) status by key District Directors will apparently be only to the regional level, where decisions by the new Assistant Regional Commissioners (Employee Plans and Exempt Organizations) will generally be final, with National Office review to be granted only on a discretionary basis.[217] This change has not yet been implemented, and the circumstances under which National Office review will still be available have not yet been specified, but presumably the criteria for discretionary review by the new Exempt Organizations Technical Branch will be similar to those now governing if a taxpayer requests that a district office refer a disputed issue to the National Office for technical advice, that is, "that a lack of uniformity exists as to the disposition of the issue or that the issue is so unusual or complex as to warrant consideration by the National Office."[218]

The Service undoubtedly expects this revised appellate procedure to reduce the number of cases involving protracted delay, by reducing the National Office caseload and enabling appeals from district determinations to be heard at a regional office located closer to the affected organization's own headquarters; each of seven regional offices will have an appeal caseload limited to cases arising within its own region. With due allowance for a breaking-in period for the new regional review function, the Service's expectation of more rapid case dispositions may well be borne out. In this respect much may depend on whether there is also substantial change in the present criteria for initially referring new exemption applications to the National Office for a ruling rather than for processing by determination letter at the district level (see pages 2592-93 above); under the new appeal procedure this initial decision will essentially establish the division between cases resolved by the National Office and those resolved by the district and regional offices.[219]

The new appeal procedure seems likely to create a risk of inconsistent results among the seven regional offices.[220] This problem, already familiar to practitioners experienced in other areas of the tax laws, has not previously been severe in the exempt organizations area because of the assurance of National Office review. The elimination of that assurance places a high premium on the quality of regional reviewers and on careful monitoring of regional decisions by the National Office.

Chief Counsel's office. The effect of the reorganization upon the handling of exempt organization matters by the Chief Counsel's office remains uncertain. Consideration is being given to creating a new Assistant Director of Chief Counsel's Interpretative Division for Employee Plans and Exempt Organizations. If this occurs, it will probably be accompanied by establishing formal branches for each of these subject areas under him. Such a branch for exempt organization matters would likely be staffed by the same docket attorneys and reviewers who now handle these matters in the Interpretative Division.

Apart from any reorganization of the Chief Counsel's office, the statutory changes are likely to affect relationships with that office. The personal expertise of any particular Assistant Commissioner (Technical) and of his immediate staff has affected the referral of exempt organization questions to the Chief Counsel's office, since the formal criteria for referrals are vague (see page 2599 above). Generally, when the incumbents of these top technical positions have been less familiar with exempt organization matters, the Chief Counsel's concurrence has been sought more frequently. Since the new Assistant Commissioner and his Deputy can be expected to have substantial expertise in exempt organization matters, the volume of referrals to the Chief Counsel's office may diminish. In addition, in cases of disagreement between the technical staff and the Chief Counsel's office, greater exempt organization expertise at the assistant commissioner level may reduce the inclination to defer to the Chief Counsel's position. The result in both these respects should be to accord greater weight to judgments of the Technical Branch's professional staff, which seems generally receptive to broad concepts of charitable purpose.

Planning, research, and publications. At least for the present, the new Assistant Commissioner's office will apparently not have its own Planning and Research staff, but there remains a possibility that such a staff capacity may be acquired in the future. The Assistant Commissioner (Planning and Research) is now responsible for these functions for the Service as a whole. Under his supervision, the Planning and Analysis Division develops and administers system "for analyzing all Service programs – with the aim of optimizing the collection of internal revenue taxes;" the Research Division conducts "advanced research into the Federal tax system to develop new approaches to improve the Service's operations," furnishes "leadership and coordination for the program of Federal-State cooperation in the field of tax administration," and participates in preparing "legislative proposals and regulation revisions resulting from the research conducted;" the Statistics Division prepares statistics "to provide basic information for tax studies and legislation" and "for the Federal benchmark statistical programs on income, wealth and finance."[221]

These analytical functions are essential in the exempt organization area. In view of the differences between the objectives in this area and those of revenue collection, it seems desirable that the new Assistant Commissioner's office have its own Planning and Research capacity. This would be consistent with the congressional intent that the new office assume coordinated responsibility for the Service's functions with respect to the exemption area in lieu of other offices whose "natural tendency is . . . to emphasize those areas that produce revenue," and that the new Assistant Commissioner direct Service policy "in connection with the basic activities of the Service relating to . . . exempt organizations."[222]

It appears less likely that the new Exempt Organizations Division will acquire its own publications, data processing or tax collections capability. These functions are not inherently related to substantive objectives. It may be uneconomical to duplicate existing capabilities. If the Service's publications program in the exempt organization area is substantially expanded (see discussion at pages 2661-64 below), it may well become appropriate for the new Assistant Commissioner's office to have its own publications capacity.[223]

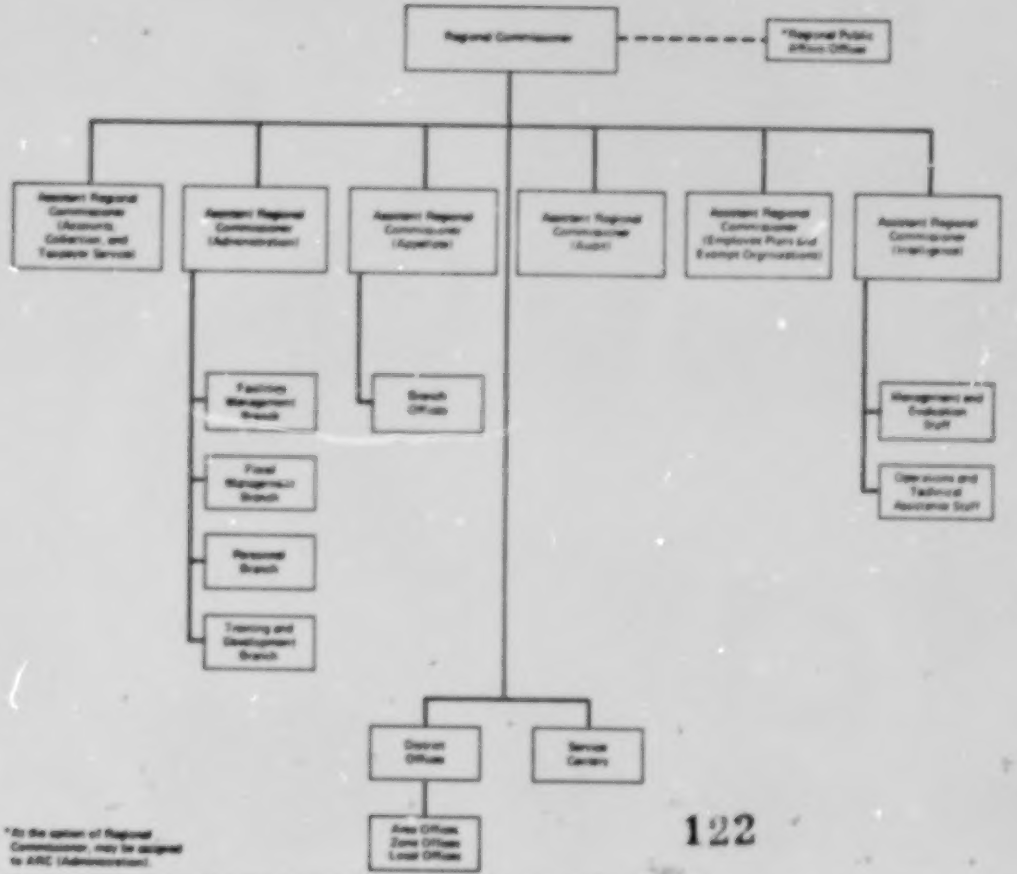
District and Regional Levels

The new structure of the Service's field organization in this area consists basically of the establishment, at both regional and key district levels, of new Employee Plans and Exempt Organizations (EPEO) offices with administrative line authority running directly to the key District Directors and Regional Commissioners, and of the transfer to these new EPEO offices of all pertinent responsibilities that have heretofore been administered through Audit personnel. Each of the seven regions now has an Assistant Regional Commissioner (EPEO); each of the key districts now has an EPEO Division headed by a Division Chief. (See the new organizational charts reprinted at pages 2628-29 below.) Functional supervision of field offices in exempt organization matters is now provided by the National Office's Exempt Organizations Division under the new Assistant Commissioner.

The exempt organization responsibilities of the Assistant Regional Commissioner (EPEO) are essentially the same as those of the previous Regional Exempt Organization Program Coordinators (see page 2592 above), but with increased administrative authority and with the important additional responsibility of managing the appeals

Exhibit 1114-1

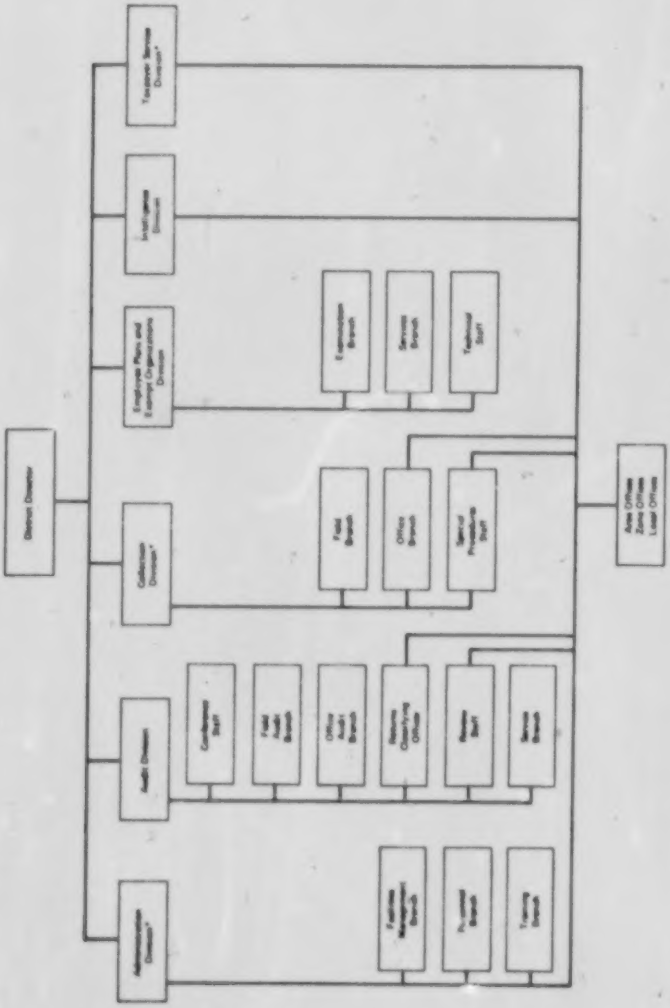
Organization of the Office of Regional Commissioner


Regional Commissioner
*Regional Public Affairs Officer
Assistant Regional Commissioner (Accounts, Collection, and Taxpayer Service)
Assistant Regional Commissioner (Administration)
Assistant Regional Commissioner (Appeals)
Assistant Regional Commissioner (Audit)
Assistant Regional Commissioner (Employee Plans and Exempt Organizations)
Assistant Regional Commissioner (Intelligence)
Facilities Management Branch
Fiscal Management Branch
Personnel Branch
Training and Development Branch
Branch Offices
Management and Evaluation Staff
Operations and Technical Assistance Staff
District Offices
Service Centers
Area Offices
Zone Offices
Local Offices

*At the option of Regional Commissioner, may be assigned to ARC (Administration).

Exhibit 1118-1

Organization of the Office of District Director Typical Chart (Amended by MS CR 11G–74)


District Director
Administration Division*
Audit Division
Collection Division*
Employee Plans and Exempt Organizations Division
Intelligence Division
Taxpayer Service Division*
Conference Staff
Field Audit Branch
Office Audit Branch
Returns Classifying Office
Review Staff
Service Branch
Facilities Management Branch
Personnel Branch
Training Branch
Field Branch
Office Branch
Special Procedures Staff
Examination Branch
Services Branch
Technical Staff
Area Offices
Zone Offices
Local Offices

*In some Districts, combined Collection and Taxpayer Service Division program for the region.[224] Tax-law specialists are to be assigned to conduct regional office conferences with the affected organizations in such appeals. Some of the new regional (as well as key district) tax law specialist positions are already being filled by transfer of experienced staff from the Exempt Organizations Technical Branch in the National Office; others are to be filled by new recruitment (largely of law school graduates) and, in a few selected cases, by reclassification of experienced key district specialist reviewers.

At the key district level, the new EPEO Divisions will typically have an Examination Branch processing audits and applications for determinations (substantially as the key district specialists have previously done); a Technical Staff reviewing determination letters, audit reports, and protests; and a Service Branch performing clerical and record-keeping functions.[225] The Technical staff, to be comprised of tax-law specialists, is to have "primary responsibility for maintaining quality standards in determination letters, examinatons, and reports, and the technical accuracy of all matters subject to review," and to act as technical adviser to the Chief of the District EPEO Division.[226]

District directors of the key districts, to whom authority has been delegated to issue, modify, or revoke determination letters involving tax-exempt organizations in cases clearly governed by established precedents that have been published in the Internal Revenue Bulletin, are now authorized to re-delegate that authority. For issuance of determination letters, redelegation is permitted not below Internal Revenue Agent and Tax Law Specialist, GS-12, provided such individual is a person other than the initiator. For revocation or modification of determination letters, redelegation is permitted not below the Chief, EPEO Division.[227]

At both the district and regional levels, employee-plan specialists are integrated into the EPEO offices. The recent expansion of key districts from 16 to 19 facilitates this. However, it is not expected that the same personnel will handle both employee plan and exempt organization matters; in most district and regional EPEO offices specialized units are established for the two responsibilities.[228]

It may take some time for loyalties of field personnel to shift to the new Assistant Commissioner's office after the long-established relationships with the Technical and Audit Divisions of the National Office. But this shift should be facilitated by the upgraded status of both the new field and new National Office organizations and by the effect of introducing tax-law specialists into the Service's field structure for the first time. These changes augur a substantial improvement over time in the esprit as well as the qualifications of exempt organization field personnel.

As we indicated at the outset of this chapter, the creation of the Office of Employee Plans and Exempt Organizations, and of the new Assistant Commissioner, provides the Service with an opportunity to remedy its present weaknesses in dealing with exempt organizations, including philanthropic organizations. The organizational changes discussed above will be helpful but only the enthusiasm and competence of the new Assistant Commissioner and the support he receives from the Commissioner and other high Service officials can determine whether the Service will in fact capitalize on its opportunity.

One very real concern is the apparent level of funding for the new office, and the fact that the formula for funding places the primary burden for supporting the office on a relatively small part of its constituency. A second concern is that the office may devote itself primarily to the needs of employee plans and neglect the problems of exempt organizations.

Given these concerns, it is only prudent for the appropriate congressional committees and the organizations affected to follow the development of the new office closely and to evaluate its performance periodically. A thorough review of the new office should be undertaken after it has had an adequate chance to become established, for example, in five years. By that time the effects of the present reorganization, of the now imminent applicability of the unrelated business income tax to churches (see page 2601 above), and of the Service's response to improved knowledge of charitable operations through data to be produced by the TCMP-Exempt Organizations Program (see pages 2610-11 above and 2660 below), should be substantially clear.

IV

PHILANTHROPY AND THE CIVIL SERVICE COMMISSION, POSTAL SERVICE, AND AGENCY FOR INTERNATIONAL DEVELOPMENT

Although the principal federal oversight role in philanthropy is exercised by the Internal Revenue Service, certain other federal agencies also have an indirect supervisory impact by setting eligibility requirements for access to privileges and benefits made available to philanthropy by the federal government. The Civil Service Commission determines which charitable organizations may participate in on-the-job solicitation of federal employees for contributions. The Postal Service determines eligibility of exempt organizations for special second- and third-class mailing privileges. The Agency for International Development (through the Advisory Committee on Voluntary Foreign Aid) determines which charities are eligible for federal benefits made available to volunteer agencies operating overseas. We summarize below the federal role in each of these areas, with some comments.

Civil Service Commission

The federal government has long encouraged federal employees to contribute to worthy charities through coordinated solicitation campaigns conducted on the job in federal offices and military installations. Responsibility for this program is vested in the Chairman of the Civil Service Commission under a 1961 Executive Order of the President.[229] The program includes endorsement of each campaign by agency heads, assignment of federal personnel to coordinate and conduct the campaigns (with person-to-person solicitation conducted by a "keyman" selected for each 25 employees), and authorization of payroll deductions for contributions to the annual Combined Federal Campaign.[230]

About 3.8 million federal employees and military personnel, at 493 locations throughout the country, were covered by the 1973 program, which raised over $55 million for the charitable organizations that shared its benefits. Half the contributors, and three quarters of the contributions, were by the payroll deduction method.[231] In 1974, contributions through the program increased to $65 million.

Eligibility Standards

Eligibility of charitable organizations to participate in this federally sponsored fund-raising program is controlled by the Chairman of the Civil Service Commission under broad authority granted him by the 1961 Executive Order. The original 1957 Executive Order on this subject limited participating charities to "national voluntary health and welfare organizations,"[232] but the President's 1961 order authorized participation by "such other national voluntary agencies as may be appropriate." The criteria prescribed by the Civil Service Commission's Chairman for determining appropriate participants are set forth in the *Manual on Fund-Raising Within the Federal Service,* issued by the Chairman in 1963 and republished without change in 1973. The Chairman's manual declares that "only . . . agencies having specific functions in the fields of health, welfare or recreational services, or in the provision of international services consistent with the policies of the U.S. Government may be approved."[233]

Although the manual has never been published in the Federal Register, proposed amendments to the manual were published in the Register in December 1974.[234] These amendments, expected shortly to become final, redefine the general standard of eligibility as follows:

> Only nonprofit, tax-exempt agencies, supported by voluntary contributions from the general public, providing direct services to persons in the fields of health and welfare services, or in the provision of international services consistent with the policies of the United States Government are eligible for approval.

No change, however, is pending in the manual provisions that more specifically limit eligible participants to these four categories:

- Local community chests, united funds and other federated groups which are members of, or recognized by, the United Way of America (about 500 participate);
- National health agencies providing research and public education on a national basis in addition to local services, such as the American Cancer Society and American Heart Association (a total of 14 agencies have been approved);
- International service agencies providing a function which involves health, welfare or "freedom building programs" in foreign countries, such as CARE and Project HOPE (a total of 10 have been approved);
- The American Red Cross.[235]

Since the four categories of eligible participants remain unchanged, the effect of the manual's current redefinition limiting participating organizations to those providing "direct services to persons" is not clear. Nor does it seem clear that all four of the presently approved categories meet that criterion.

In recent years, as more charitable groups have become aware of the Combined Federal Campaign and applied to participate, the question has arisen within the Chairman's office whether the presently acceptable categories should be expanded to include organizations conducting other types of charitable programs – in fields such as education and the arts. Thus far the CSC Chairman's Eligibility Committee has dealt with this question by encouraging local organizations that apply to seek qualification through admission to a United Way affiliate; national agencies can qualify under the Chairman's present criteria only in the fields of health or international service.

The CSC Chairman's authority to limit local participant agencies to those included through a Community Chest or United Fund (in locations having such federated umbrella groups) has been upheld by a federal district court as a reasonable means of permitting local health and welfare agencies to participate in the Combined Federal Campaign without unduly burdening the normal operations of the federal government. Otherwise, federal officials would have to pass on every application of thousands of local health and welfare agencies in communities across the nation.[237] Although observing that it would be an abuse of discretion if the Chairman were entirely to re-delegate his authority to the United Way and its member United Funds and Chest, the court found that the Chairman had not done so. The Chairman's manual requires all agencies participating as members of a United Fund or Community Chest in the Combined Federal Campaign to meet independent federal standards regarding such important matters as nondiscrimination.[238]

Under the Chairman's current application of the Executive Order, charitable organizations that are not members of local United Way federations are eligible only if they qualify as "national voluntary agencies" in the fields of health or international service.[239] The Chairman's manual requires such an applicant to demonstrate "national scope" by showing that it is organized on a national scale, that it has earned "good will and acceptability throughout the United States," that it has enough fund-raising representatives at decentralized locations to be able to enter fully into local campaigns throughout the country, and, if a national health agency, that it has sufficiently developed local chapter or affiliate coverage to implement its local program in locations where there are large numbers of federal personnel. The manual expressly provides:

> Good will and acceptability will usually be shown by operating chapters providing service in all or most of the states, with contributor support from all or most parts of the nation. Good will and acceptability throughout the United States will also be demonstrated by other means, such as the extent of support received from the public, the number and location of contributors, the national character of campaigning directed to the public, the reputation of the organization on a national basis, and the proportionate effect on total income of the organization's participation in the Federal program. In the case of international agencies, chapter or affiliate coverage in all or most states need not exist.[240]

Failure to meet these "national scope" requirements is one of the most common reasons for rejection of applications. However, since international service agencies are expressly exempted from the requirement that chapters exist in all or most of the states, the requirement of widespread chapters effectively applies only to national health agencies (the only remaining eligibility category).

An additional factor limiting participants is the manual's rule on "Avoidance of Competition." Under this rule, participation is limited to not more than one national health agency within a single field which deals with physical handicap or disease. The currently proposed amendments to the manual also limit approval of international service agencies to not more than one meeting a particular human need in the same geographic area, unless there is a "demonstrated need for such additional service."[241]

Specific Requirements

The nondiscrimination requirements specified by the Chairman's manual apply to all participating organizations, including member agencies of local United Funds or Community Chests. Adherence to the "Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations"[242] is also required of each participant except the Red Cross (which is "recognized as operating an accounting and financial system in substantial compliance with" those standards). An annual certification by an independent accountant of compliance with those standards is required of each participating national agency except the Red Cross;[243] the United Way of America is relied upon to certify such compliance on the part of its local affiliates and their member agencies.[244]

Other specific requirements relating to fund raising and financial reporting are applicable only to national voluntary agencies (it being assumed that the United Way will adequately screen local participating members in these respects):

Administrative and Fund-Raising Expense. Administrative and fund-raising expenses which are reasonable. Expenditure for administration and fund raising not exceeding 25 percent of total support and revenue will be considered reasonable. Where administrative and fund-raising expense exceeds this percentage, the burden is on the voluntary organization to demonstrate the reasonableness of its fund-raising expenses under all the circumstances.

Fund-Raising Practice. Publicity and promotional activities based upon the actual program and operations of the agency and which is truthful and nondeceptive and which includes all material facts; protection afforded against unauthorized use of agency contributors' lists; no payment of commissions, kickbacks, finder fees, percentages, bonuses or overrides for fund raising; no mailing of unordered tickets or commercial merchandise with a request for money in return; and no general telephone solicitation of the public.

Source of Funds and Costs Report. Filing of special report with Chairman of the Civil Service Commission which discloses on a consolidated basis the agency's (including its chapters and affiliates) source of funds, fund-raising expenses, and use of net funds in its most recent fiscal year.

All participating national voluntary agencies except the Red Cross and the United Way must file annually the Source of Funds and Costs Report and a statement that the fund-raising practice requirements have been complied with. No particular mechanism is prescribed for assuring compliance with the requirements concerning administrative and fund-raising expense.[245]

Comments

Federal sponsorship of this program illustrates the government's recognition of the important role of private philanthropy in our society. The program seems to have been well conducted, the specific requirements concerning financial and fund raising practices of participants have encouraged adherence to those requirements by a large segment of voluntary effort in the United States, and contributions obtained through the program (most recently at an annual level of $65 million) have provided important support for the participating charities.

The question of access to participation by a wider range of charitable organizations is a difficult one. Reliance upon 500 local affiliates of the United Way to screen thousands of local participating agencies relieves federal officials of an enormous administrative burden; it also avoids what could be an undesirable degree of governmental interference in private charitable activity.[246] Nevertheless, in view of wide variation in local requirements and practices affecting access to membership in United Way affiliates, it would seem desirable to explore possible means for achieving greater flexibility in this respect without unduly increasing the federal administrative burden. Where voluntary agencies in fields such as education and the arts are not admitted to local United Way affiliates, access to participation might be considered through other umbrella organizations that could similarly undertake screening and administrative responsibilities under the manual's standards.

The limitation of eligible national agencies to the Red Cross and to health and international service agencies, while grounded in the history of this program, appears anomalous. The President authorized participation of any "appropriate" national voluntary agency. Although the Chairman's standard of "national scope" has generally required chapters or affiliates in all or most of the 50 states, the Chairman has exempted international service agencies from this requirement; it may be appropriate similarly to recognize national character, by criteria other than state chapters, in other areas of charitable activity as well. We believe the Chairman should consider methods of broadening eligible program categories beyond their historical narrow limits, recognizing the need to avoid undue administrative burdens.

We also believe the Chairman should consider eliminating the exemptions enjoyed by some present national agency participants from the specific requirements of independently certified compliance with the Standards of Accounting and Financial Reporting, and of an annual Source of Funds and Costs Report, that apply to other participants and applicants. Similarly, the manual's rules on "Avoidance of Competition" would seem to warrant reconsideration in light of the objectives of the Combined Federal Campaign. Elimination of the exemptions and anti-competitive rules would avoid any appearance, however unjustified in fact, of a preferred position accorded to the status quo.[247]

Postal Service

Reduced Rate Classes

Congress has since 1917 prescribed that reduced postal rates should be accorded for publications of nonprofit religious, educational, scientific, and philanthropic organizations (and for those of certain other nonprofit organizations as well). The reasons for the policy have most recently been stated as follows:

> Historically, the rates for theses classes of mail have been kept low to encourage the free flow of ideas throughout the country and to help promote charitable causes. In the days when the printed word was the only source of universal communication, this policy was of paramount importance to the functioning of our democracy. Today, other forms of communication such as radio and television are on the ascendency. This in no way reduces the crucial importance of the material affected by this legislation to our educational, cultural, and eleemosynary interests. . . .
>
> Congress historically provided lower rates for [these] . . . classes of mail . . . to provide, at reasonable cost, the means for wide dissemination of educational, cultural, literary, and charitable materials.
>
> . . . . This legislation will strengthen the policy, already intrinsic in the Act, that certain types of mail have intrinsic value because of their contribution to the flow of opinion and information essential to the functioning of our democracy.[248]

Until 1970 the classes of mail entitled to reduced rates and the rates themselves were specified by statute.[249] The Postal Reorganization Act of 1970 omitted the previous statutory provisions mandating the reduced rate classes, instead authorizing the Postal Service generally to establish "reasonable and equitable" mail classes and rates. In principle, rates for all classes of mail were fully to cover costs. However, the 1970 act (a) directed that previous statutory provisions, such as those specifying reduced rate classes, remain in force as "rules or regulations" of the Postal Service until revoked or modified by the Postal Service;[250] and (b) provided that increases in the reduced rates, to bring them to a level that would cover costs, be phased over 10 years (5 years for commercial mailers).[251] In 1974, the phase-in period was extended to 16 years (8 years for commercial mailers).[252]

Charitable organizations receive several types of preferential rates. Their publications are accorded a special second-class (newspapers and periodicals) rate that is lower than that available to other second-class mailers; in addition, unlike commercial mailers of second-class mail, they may qualify for this rate in many cases without having a paid subscription list, so long as they do not carry general advertising. Similarly, charitable organizations receive a special third-class (bulk mailings of printed matter) rate that is lower than that available to other third-class mailers. Fourth-class mail includes a special "library rate" for books and other educational materials when loaned or exchanged between charitable organizations and for films, records, museum materials, and scientific devices when sent to or from such organizations.[253]

Eligibility Standards

Until 1973, no postal law or regulation specified what charitable organizations were eligible for the preferential rates. Local postmasters exercised administrative discretion under a broad statutory standard, originally enacted in establishing the second-class nonprofit mailing rate in 1917, which provided simply for preferential rates to "religious, educational, scientific, philanthropic, agricultural, labor, or fraternal organizations" (later extended also to veterans organizations and certain others) that were "not organized for profit and none of . . . [the] net income [of which] inures to the benefit of any private stockholder or individual."[254] Significantly, it was in the same 1917 statute that Congress first provided an income tax deduction for contributions to charitable organizations, described in almost identical language. It thus seems clear that these terms were intended to have the same meanings in the postal laws as in the revenue laws.

Postal regulations defining these terms were first issued in 1973. In announcing those regulations (described as based on long-standing administrative interpretations made through the years), the Postal Service noted that its definitions "parallel similar definitions in use by other Government agencies," that the word "philanthropic" has been historically interpreted by the Postal Service as synonymous with "charitable," and that generally an organization will qualify for the preferential mail rates if tax exempt under Internal Revenue Code sections 501(c)(3) as charitable, 501(c)(5) as an agricultural or labor organization, 501(c)(8) as fraternal, or 501(c)(19) as a veterans organization.[255] The postal regulations adopt verbatim the language of the parallel Treasury Regulations that define "educational" and "charitable" organizations under section 501(c)(3), and also define "scientific" in substantially the same way as under the Internal Revenue Code. Unlike any Treasury Regulation, the Postal Service also provides a definition of "religious" organizations.[256]

The 1971 postal laws providing for preferential rates were never amended, as sections 501(c)(3) and 170(c) of the Internal Revenue Code were in 1934, to exclude philanthropic organizations that engage in substantial attempts to influence legislation (see pages 2614-15 above). Nevertheless, the Postal Service has construed the term "philanthropic" in the postal laws as though it had been similarly amended. Thus, the 1973 postal regulations include verbatim the language adopted by Treasury Regulations in 1959 disqualifying for 501(c)(3) status all "action" organizations, that is, those devoting a substantial part of their activities to attempting to influence legislation, participating in any political campaign on behalf of or in opposition to any candidate, or advocating a primary objective that may be attained only by legislation. All such "action" organizations are equally disqualified by the Postal Service for the preferential mail rates otherwise available to religious, educational, scientific, or philanthropic organizations.

This exclusion seems difficult to rationalize under existing law; the issue arises sharply for organizations exempt from income tax under Internal Revenue Code section 501(c)(4). Both the Postal Service and the Internal Revenue Service acknowledge that charitable purposes include the "promotion of social welfare."[257] Under the Internal Revenue Code, the essential differences between 501(c)(3) charities and 501(c)(4) "social welfare" organizations are that the latter remain free to engage in substantial legislative activities and are not eligible to receive deductible contributions under section 170(c).[258] The distinction drawn by Treasury Regulations between 501(c)(3) organizations and those promoting social welfare by "action" has a statutory basis in the 1934 amendments to the Internal Revenue Code. However, the Postal Service's insistence that organizations promoting social welfare by "action" are not "philanthropic," as that term has been used in the postal laws since 1917, has, as noted, no equivalent statutory basis. The validity of the postal regulation disqualifying "action" organizations may be tested in two currently pending court cases involving the Postal Service's revocation of preferential mail rates of the Sierra Club and the National Rifle Association, both 501(c)(4) organizations.[259]

Eligibility Determination and Appeal Procedure

Eligibility of applicants for special nonprofit second-class rates is decided by the Director, Mail Classification Division, of the Postal Service's Finance Department, who also issues suspension or revocation rulings.[260] Although IRS recognition of 501(c)(3) status is usually regarded as sufficient to establish an applicant's qualifications, in some cases the Mail Classification Director rejects applications of 501(c)(3) organizations for special second-class permits upon concluding, after reviewing copies of the organization's periodical, that the objectives of the organization differ from those stated in its charter. We believe it anomalous for the Postal Service, applying the same statutory standard as the Internal Revenue Service (see page 2636 above), to conclude independently that an organization whose 501(c)(3) status is recognized by IRS is nevertheless not qualified as "philanthropic." At the least, if the Postal Service does not defer entirely to a favorable IRS determination of an organization's basic qualification, the Postal Service should afford the affected organization full procedural rights before reaching a contrary conclusion.

An evidentiary hearing before an Administrative Law Judge is now available upon appeal from the Mail Classification Director's ruling only if *both* the special nonprofit second-class privileges and the higher commercial second-class privileges available to publishers are denied or revoked.[261] If only the special nonprofit privileges are denied, however, no such appeal or hearing is provided. Nor in such cases (whether upon initial application or revocation) do the postal regulations provide the disqualified organization with any right to notice of the grounds for disqualification, to submit a written appeal, to present evidence on issues of disqualification or to test contrary evidence relied upon by the Mail Classification Director. The regulations do not require that the decision be based upon matters of record and provide no review of the decision for errors of fact or of law.[262]

Apart from constitutional questions about the basic fairness of this procedure, there seems to be no reason for granting procedural rights to commercial publishers and denying them to organizations claiming eligibility for special nonprofit rates.[263] The difference between regular second-class rates and the special nonprofit second-class rates is substantial.[264] Since only about 600 determinations of eligibility for the special nonprofit second-class rates are made annually, of which typically not more than 25 are adverse,[265] there would seem relatively little administrative burden to be incurred in providing the same appeal and hearing rights upon adverse determinations as the Postal Service now provides for commercial second-class mailers. We believe they should be provided.

The Postal Service also requires nonprofit organizations to file an application to qualify for the special third-class bulk rates. These applications, including evidence of tax-exempt status, are filed at the local post office where mailings will be deposited and are approved or disapproved by the postmaster at the nearest postal services center. An adverse decision may be appealed in writing to the same postmaster and reviewed by the Mail Classification Director, who is also the reviewing authority upon written appeals from revocation of such special third-class permits.[266] No hearing or further appeal is provided; as in the case of adverse determinations of eligibility for the special second-class rates, there is no requirement that the decision be based on the record before the Mail Classification Director, no opportunity for the disqualified organization to challenge the information relied upon by that official, and no restriction against that official serving as the reviewing authority upon revocations that he initiated.

Annually about 250 to 300 nonprofit organizations appeal to the Mail Classification Director for review of adverse local decisions on special third-class permits.[267] Some others may not exercise this right of appeal, although all rejected applicants are advised of their right to do so.

In view of the clear intention of Congress that the statutory terms describing charitable organizations and those describing organizations entitled to preferential mail rates have the same meaning in the postal laws as in the revenue laws (see page 2636 above), we believe that when an applicant for special third-class rates has been recognized by the Internal Revenue Service as tax exempt the Postal Service should provide the same opportunity for an evidentiary hearing upon adverse determinations before an impartial reviewing authority as we have recommended above for adverse determinations of special second-class eligibility.

Agency for International Development's Advisory Committee on Voluntary Foreign Aid

A substantial share of American foreign aid activity is conducted by private charitable organizations under grants from and contracts with the Agency for International Development (AID). Liaison between AID and private agencies is effected by the Advisory Committee on Voluntary Foreign Aid, attached to the Office of Private and Voluntary Cooperation of AID's Bureau for Population and Humanitarian Assistance.[268] Apart from providing such liaison, the advisory committee's major function is to determine which charitable organizations will be eligible to apply for three kinds of government benefits commonly called "subventions" – receipt of P.L. 480 food for distribution abroad, reimbursement of ocean freight charges on relief supplies and equipment sent overseas, and receipt of government-owned excess property for use abroad. By statute, the only private agencies eligible for these subventions are those "registered with and approved by" the advisory committee.[269]

Established by Presidential request in 1946,[270] the advisory committee consists of eleven citizens appointed by the AID Administrator. It meets 5 to 10 times a year, with three staff members provided by AID's Office of Private and Voluntary Cooperation.[271] Although registration with the advisory committee is necessary for organizations applying for any of the three subventions, it is not a prerequisite for receipt of AID grants or contracts. According to one recent tabulation, there are 116 private organizations rendering overseas services under AID grants or contracts, of which only 21 are registered agencies. Contractors and grantees are subjected to far more elaborate screening and supervision than attaches to advisory committee registration.[272]

AID regulations require any organization applying for registration with the advisory committee to be recognized by the Internal Revenue Service under section 501(c)(3) and, in addition, to show that

(a) Its "primary purpose" is "to further or engage in voluntary foreign aid";

(b) It is controlled by an uncompensated board of directors who "will exercise satisfactory control to assure that its services and resources are administered competently in the public interest";

(c) Its funds are obtained, expended, and distributed "in ways which conform to accepted ethical standards without unreasonable cost for promotion, publicity, fund raising, and administration at home and abroad";

(d) Fund-raising campaigns are timed to avoid conflict with similar appeals of the American National Red Cross, the Community Chests, savings bond drives by the U.S. Treasury, or similar "campaigns of accepted general national interest."[273]

Registered agencies must file with the advisory committee an annual program report and certified financial audit; all records related to activities as a registrant must be available for official inspection, and information on registration, organization and reports on programs and finances must be available for public inspection.[274]

Actually, about two thirds of the registered agencies have never participated in any of the material benefits for which registration makes them eligible. In 1973, 62 out of the 91 registrants participated in none of the subventions; in 1972, 59 out of 89 did not participate. Among those that do participate, more than 90 percent of the benefits (in dollar value) are received by only two agencies (Catholic Relief Services and CARE). Moreover, although the primary purpose of registered agencies is purportedly to further or engage in overseas aid, eight of the registered agencies in 1972 and seven of them in 1973 reported no overseas program costs whatever.[275]

Since the material benefits of registration with the advisory committee are evidently not a factor for most of the registered organizations, the question arises why they bother to register. AID and the General Accounting Office seem to agree that for many charitable organizations the principle reason for registering is to use AID's name, and the fact of such registration, as "a Good Housekeeping Seal of Approval" in public solicitations for funds.[276] The advisory committee does not have the means to screen or monitor registrants effectively; hence registration provides no reliable assurance to the solicited public of an agency's credibility, efficiency, or effectiveness.[277]

To avoid misleading the solicited public as to the import of registration with the advisory committee, the General Accounting Office concluded from its recent study that either the advisory committee should adopt an effective monitoring system (including management audits) or the agencies should not be permitted to advertise that they are registered.[278] AID is apparently considering the alternatives of registering only those agencies which actually apply for the statutory subventions or abolishing registration entirely, with the latter alternative regarded as preferable if there were established "a larger, possibly domestically oriented regulatory watch dog system which also then has an arm that looks at the foreign aspects of U.S. voluntary groups."[279] Proposed legislation recently introduced would prohibit any organization registered with the advisory committee from stating that it is so registered in solicitation material distributed to the public.[280]

Regardless of whether registration is limited to charitable organizations that actually seek use of the statutory subventions, the potential for misleading the public seems too great if registration with the advisory committee is advertised by registrants in fund-raising solicitations. We recommend that AID by regulation require any registrant to agree not to engage in such advertising as a condition of its continued registration, if registration is not abolished entirely.[281]

V

ALTERNATIVES TO THE INTERNAL REVENUE SERVICE AS THE FEDERAL OVERSIGHT AGENCY

Proposals for a National Commission on Philanthropy

Several experienced and highly respected observers have urged that present arrangements for federal oversight of philanthropy have such serious weaknesses that the Internal Revenue Service should be displaced for this purpose by a new federal agency. This view has been effectively articulated, and a proposal for a National Commission on Philanthropy put forward, by several experts who reviewed the subject following a 1972 conference on Anglo-American Philanthropy held at Ditchley Park, England.[282] We refer to this as the "post-Ditchley" proposal.[283]

The principal reasons for transferring the regulatory functions of the Internal Revenue Service to a new agency or Commission, as articulated by proponents of the post-Ditchley proposal, may be summarized as follows:

1. The Service's basic mission is to produce revenues by collecting taxes. Since supervision of exempt organizations is nonproductive in these terms, it will always be a "stepchild" within the Service. The highest priorities of personnel and budget must always lie elsewhere; charities cannot compete with income tax collections for the attention of high officials within the Service.

2. The Service is not staffed by professionals with the broad backgrounds required to evaluate the activities of charitable organizations and to deal with such basic issues as what constitutes charity. The lack of qualified personnel requires that every issue, other than the most routine, be referred to the National Office. The caliber of personnel is better in the National Office, but most professionals specialize in law or accounting; any master's degrees are in business or public administration. Moreover, the best people are apt to prefer areas other than exempt organizations – the Audit Division or corporate reorganizations – because those areas offer greater opportunity for promotion or post-Service careers. Traditionally, specialization in exempt organizations has not been a preferred route for a successful career in the Service.

3. Institutionally the Service will never be inclined to administer the law governing exempt organizations vigorously. Only pressure from an outside source can induce the Service (or the Treasury Department) to examine a particular problem in the exempt organization area. The Service thus cannot be a source of leadership and affirmative support for improved administration of charitable activities. Moreover, inattention can lead to legislative over-reactions that impede philanthropy; the Tax Reform Act of 1969 is an example.

4. The procedures and rules developed for revenue collection do not meet the special needs of exempt organizations. The Service has lacked the flexibility to adapt these rules and procedures to exempt organizations. The supervision of charities requires greater responsiveness and, perhaps, informality in providing advice (general as well as legal) to charitable organizations, such as that provided by the British Charities Commission.

5. The Service does not fill the vacuum left by the failure of the states to supervise charities. The need for uniformity among the states and the overriding national interest in the proper administration of charity requires establishment of a new federal agency.

The post-Ditchley proposal calls for a new and independent federal agency, modeled upon the Securities and Exchange Commission, with responsibility for the essential regulatory functions which the Service now performs for 501(c)(3) organizations.[284] Perhaps to be called the National Commission on Philanthropy, the new agency would be supervised by commissioners appointed by the President and confirmed by the Senate.[285] Its statutory mandate would rest on the assumption that the public interest is served as much by charity as by governmental action; the commission would therefore have affirmative responsibility to promote, encourage, and advance private philanthropy. This would include reports to Congress, the executive branch, and the public upon matters pertaining to philanthropy and philanthropic organizations, and flexible sanctions against abuse that would not depiete charity itself.

The proposed commission would have these characteristics and functions:

- The commission would be responsible for both the ruling and audit functions now performed by the Service; its determination that an organization meets the standards of section 501(c)(3) would be conclusive upon the Service for exemption and deduction purposes. Applicant organizations would have a statutory right of prompt access to the Tax Court for review of adverse determinations. However, the Service would continue to administer the unrelated business income tax for 501(c)(3) organizations;

- The commission would issue advance rulings on proposed transactions, receive annual information returns, and have several regional offices from which field-level audit personnel would operate;

- In accordance with its duties to promote philanthropy, the commission would annually compile and publish data on philanthropic organizations and their receipts and activities, maintain a publicly available register of all exempt charities, and advise Congress and the executive branch on charitable matters;

- The commission would have the duty to enforce substantive standards established by statute for the various classes of 501(c)(3) organizations. These standards might continue much of the substantive content of the 1969 legislation for private foundations and might also direct the commission to establish rules for the uniform disclosure to the public of financial information by organizations making public solicitations for funds;

- Sanctions for enforcing the standards would include civil actions before the U.S. District Courts to invoke broad equity powers of the kind possessed by the state courts enforcing state fiduciary law. In recognition of the states' powers and responsibilities in regard to charity, the statute conferring such powers upon the federal courts would provide for stay of the federal equity action brought by the commission if state officials initiate parallel state court action, with the federal court then authorized only to take action consistent with any final state court action, much as the Treasury Department proposed to the Ways and Means Committee in 1969;

- The commission should be nonpartisan, objective, fair-minded, and independent in its operations;

- The commission should be manned both at policy and staff levels by well-trained individuals with the necessary educational background and experience to deal competently with the needs and problems of the charitable field.

Many of the specific functions suggested for the proposed commission should be carried out, whether by a new commission or otherwise. We address below the collection and publication of data on philanthropy (pages 2661-64), equity enforcement powers (pages 2658-60), judicial review of adverse status determinations (pages 2660-61), and disclosure requirements for fund-raising solicitations (pages 2644-58).

Evaluation

There is obvious merit in the proposal to establish a National Commission on Philanthropy. The supervisory functions of the Service with respect to philanthropy result from history and convenience, not rational design. Although we believe that these functions are discharged with greater sensitivity than is normally attributed to the Service, many of the points made above are valid.

Perhaps the most important factor in our thinking has been the first touchstone listed in the Introduction: Federal regulation should be objective, nonpartisan, and non-ideological. The record of the Service in this respect has been good (if not perfect), and it is known. There is no way to assure that the record of a new commission will be as good; the defects of the Service do not seem to us so large, on balance, as to justify the risk.

One can of course attempt to insulate a new commission from improper influence through organizational devices, and checks and balances. The history of federal agencies, however, demonstrates that organizational arrangement is only one factor in shaping the life of an organization. Some federal agencies discharge their tasks with creativity and independence; others are docile captives of the Congress, the industries they regulate, or the executive branch. The result seems to depend as much on personnel appointments, the climate, the interest of particular Congressmen or congressional committees, and similar factors, as it does on the objectives and organizational charts set forth in the enabling legislation.

Moreover, the agency that regulates philanthropy must be non-ideological and objective internally as well as free from external influence. The regulators themselves must not only exercise self-restriant but enjoy public confidence that they do. Here, the Service's weakness may also be its strength. The substantial enlargement of the parameters of charity authorized by the Service over the past 15 years has, in retrospect, been accompanied by relatively little political controversy (with few exceptions). This is in part attributable to the public image of the Service (which corresponds to reality) as an organization largely unaffected by partisan or ideological consideration.

We think it is better for charities to accept the inherent limitations of the Service and retain the deep tradition of independence, than to seek a structure that may be more rational in theory but will present substantial risks in practice.

The risks of change might be justified if the problems with the Service were intolerable and it was reasonable to expect that these problems would be surmounted by a new agency.

In fact the major criticisms of the Service relate to procedural delays and to the caliber of some of its personnel. In performing what is probably its most sensitive task – ruling on qualifications for exempt status – the Service seems to have performed well. Even the delays are not unreasonable in view of the increase in exemption applications, the difficulty of the issues dealt with, and the burdens of the 1969 Tax Reform Act. (The monumental task of preparing regulations under the 1969 act was performed by the Service with great sensitivity and close consultation with the organized bar).

And it is not at all clear that a new National Commission on Philanthropy would be immune from some of the bureaucratic afflictions of the Service. A sizable staff would be required; regional offices and districts would be set up. The proposed commission might thus preside over a large bureaucracy with its own delays and similar problems. In practice, since the expertise of the Service could not easily be duplicated, the new commission would be staffed initially with exempt organization specialists from the Service, particularly in the rulings area which requires knowledge of past practice. Budgetary limitations would necessarily affect the qualifications of field staff.

There is also a logical nexus between tax collection and exemption determinations that argues against the proposed transfer of functions. It seems sensible for the authority charged with enforcing the tax laws to determine who is exempt from tax under those laws.[286] There would also be practical difficulties in transferring functions because the exemption provisions are interrelated with other Internal Revenue Code provisions. The practical difficulties are illustrated by the following exemption provisions which require for their application an interpretation of Code provisions relating to nonexempt matters or otherwise outside the proposed commission's jurisdiction:

- Section 502 (disqualifying feeder organizations) defines "trade or business" by reference to section 512 (unrelated business taxable income), which the post-Ditchley proposal would leave subject to IRS administration;

- Section 4946 defines disqualified persons by reference to indirect stock ownership under section 267(c);

- Section 4948 (exemption of foreign organizations) requires a determination of income "derived from sources within the United States" under section 861;

- Sections 4941 (self-dealing) and 4945 (taxable expenditures) require application of the definition in section 151(e)(4) of an "educational institution" in which a taxpayer's dependent may be enrolled for individual income tax exemption purposes;

- Section 503 (prohibited transactions) requires application of section 267(c)(4) to define a creator's or substantial contributor's "family";

- Section 507 (termination of private-foundation status) requires application of all income tax provisions of the Code to determine the aggregate tax benefit of exemption;

- Section 4940 (tax on net investment income) requires application of sections 167 (depreciation), 611 (depletion), 103 (interest on governmental obligations), and 265 (deduction for expenses and interest relating to tax-exempt income) to determine a foundation's net investment income;

- Section 509 (defining private foundations) requires application of section 170(b)(1)(A) defining organizations to which an individual's contributions are subject to a 50 percent limitation for deductions purposes;

- Section 4945 (taxable expenditures) requires application of section 117, defining scholarships and fellowships excludable from a taxpayer's gross income, and section 170(c)(1), defining governmental units to which contributions for public purposes are deductible;

- Section 501(c)(3) itself requires application consistent with section 162 (ordinary and necessary business expenses) in determining whether an organization's "net earnings" inure to private benefit, with sections 170(c)(2), 2055(a)(2), and 2522 governing deductions for charitable contributions, with sections 107 and 1402(e) in determining those entitled to tax treatment as clergymen, and with sections 3121(b)(8)(B) and 3306(c)(8) in determining whether an organization is exempt from social security and unemployment taxes.

Administration of the unrelated business income tax by the Service would require duplicate audits, by the Service as well as by the commission staff, for all 501(c)(3) organizations. The Service would be left to decide what activities are "substantially related" to "the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption" (section 513). If the commission administered the tax on unrelated business income, it would be computing income tax liabilities parallel with the Service, which seems undesirable. The tax would then be administered by two agencies, since the unrelated business income tax would continue to apply to other categories of exempt organizations which would remain subject to the jurisdiction of the Service (see page 2602 above).

Finally, the establishment of the new Assistant Commissioner reinforces the case against transferring the Service's functions to a new agency since it provides an opportunity for improvement within the Service; by current indications that opportunity is being seized with a fair degree of vigor.

VI

FEDERAL REGULATION OF INTERSTATE FUND RAISING

The Need for Federal Regulation

Reported philanthropic contributions amounted to $25.2 billion in 1974, of which more than 86 percent came from individuals, 4.9 percent from corporations, and 8.4 percent from foundations.[287] The data are incomplete; informed observers estimate that unreported contributions – almost entirely from individuals (most of whom elect the standard deduction instead of itemizing contributions and other personal tax deductions) – may equal those reported. Charitable fund raising is thus a big business, equal to about 4 percent of the Gross National Product. While private foundations are subject to detailed regulation under chapter 42 of the Code, the fund-raising activities of public charities are not supervised or monitored by the federal government,[288] despite indications of abuses.

The case for federal regulation of interstate charitable solicitations rests essentially on three premises:

First, given the amount of money at stake, the professionalization of fund raising, the relative lack of sophistication of many individual donors, and the emotional overtones of charitable appeals, there is a clear potential for abuse.

The National Information Bureau emphasizes that "philanthropy involves big money" and cautions members:

> Where there is big money, not always properly controlled, there is enticement for wrong-doing. Greedy individuals are likely to manipulate themselves into power within nonprofit agencies. Moreover, unscrupulous commercial businesses may become active in this field such as computerized direct-mail fund-raising houses that specialize in "cause" fund raising, i.e., the mailing of millions of computerized fund-raising appeals in a hurry after a disaster hits the headlines, using as the letterhead "front" for their business a totally inexperienced and frequently irresponsible nonprofit group. The cost of fund raising in such "cause" operations may range to 90 cents of each $1.00 contributed in response. Thoughtless contributors help this process by assuming that if the "cause" is good the philanthropic organization asking them for a contribution must be sound. Unfortunately, the logic is faulty.[289]

The overwhelming majority of reputable charities and fund raisers are aware that it is no disservice to them to recognize the potential for abuse.

Second, it is difficult to determine the extent of fraud and similar abuses in charitable solicitations, but the numerous accounts of abuses in congressional testimony and elsewhere suggest that they are not infrequent.[290]

In some reported cases, fund-raising expenditures alone consume as much as 60 to 80 percent of the contributions received through direct mail solicitations.

Mailing lists are such a valuable asset in the charitable fund-raising business that one professional fund raiser reportedly uses a charity organized by himself merely to solicit signatures, without seeking any contribution, to accumulate a potential list of contributors that can be used in soliciting for other organizations at a fee.

Other fund-raising promoters, using telephone rather than mail techniques, conduct "boiler-room" operations using hired "phonemen" to solicit in the name of small charitable organizations, with "runners" sent out promptly to collect promised contributions; the percentage of returns retained by the promoter can be many times that paid to the charitable organization (in effect for the use of its name).[291] The child described in one foster parents magazine solicitation as a five-year-old boy is actually a 12-year-old girl already supported by regular donations.[292] And recipients are seldom told that the unsolicited items enclosed in a solicitation letter need not be paid for or returned.[293]

The practice of compensating professional fund raisers with a percentage of contributions received, provides an incentive for unethical solicitors to make false or misleading statements in charitable solicitations. The practice is apparently not infrequent, although it is forbidden by the Civil Service Commission for solicitations of federal employees[294] and condemned by the ethical standards of the American Association of Fund-Raising Counsel (AAFRC), the National Society of Fund Raisers (NSFR), the National Information Bureau, and the Council of Better Business Bureaus.[295]

Even if solicitation abuses are relatively infrequent, the publicity they receive coupled with the absence of effective regulation can impair public confidence in charitable fund raising generally.

Third, assuming a need for regulation of charitable solicitations and professional fund raisers, it seems clear that only the federal government can adequately do the job.[296] State regulation, self-regulation, and monitoring by organizations of donors should be encouraged, but these are not sufficient, and, in our view, cannot be made so.

Large fund-raising drives involve many states, in various ways. The charitable organization for which contributions are to be solicited may be incorporated in one state, have its headquarters in another, and conduct mailings from still another. The same is true of the fund raiser, who plans and executes the solicitation. Some fund raisers operate on a transient basis. Donees will be found in many states. Mail or telephone solicitations originating in one state and directed to donees in another state cannot easily be controlled by the latter state. This pattern is likely to leave no single state with sufficient interest to regulate vigorously.

Even where state regulation is vigorous, enforcement can be evaded by allocating expenses and receipts arbitrarily among states so as to comply with specific state limitations.[297] Moreover, only about one half of the 50 states in fact regulate the solicitation of funds for charitable purposes, and the coverage and scope of regulation vary widely.[298] While the federal legislation proposed below is not intended to preempt the states from continued regulation on the local level, the interstate character of the typical fund-raising drive makes exclusive reliance on state regulation unrealistic.

Self-regulation has been useful, and should be expanded and encouraged. Two associations of professional fund raisers determine ethical standards for their members, the American Association of Fund-Raising Counsel and the National Society of Fund Raisers. However, only 29 fund raising firms are members of the

AAFRC, compared with an estimated 200 to 20,000 such firms (not including direct mail firms); only about 1,500 individual fund raisers are members of the NSFR, compared with an estimated 15,000 to 50,000 individuals in the business of fund raising.[299] Moreover, professional and trade associations must rely on voluntary cooperation from their members and have no effective means of enforcing their standards.

Two nonprofit organizations provide information about solicitations. The most extensive service is the Philanthropic Advisory Department, Council of Better Business Bureaus (CBBB). The CBBB has adopted reasonably detailed standards for charitable solicitations and responds to requests for information. Although the information program has been actively conducted for only three years, and is still not well known, the CBBB received 175,000 inquiries in 1973; the inquiries increased during 1974 to more than 525,000, demonstrating the public's desire for a reliable source of information.[300] The CBBB, however, has a staff of three and a budget of $35,000. The only other information service that we are aware of, the National Information Bureau, reports only on about 500 charities that conduct national fund-raising campaigns; it provides these reports to member firms and subscribing individuals only, for a minimum of $15 per year for individuals and $25 per year for corporations and foundations.

The greatest obstacle to self-regulation is not lack of resources – presumably private funding could be found, for example, to enlarge the valuable work of the CBBB. Neither the CBBB nor NIB can compel charities to provide information. Between 20 and 25 percent of the soliciting charities about which the CBBB receives inquiries from the public either refuse to respond to CBBB questionnaires or respond less than forthrightly. To compel the production of truthful information requires the authority of government. And self-regulation cannot prevent fraud or compel redress when it occurs.

The Current Role of the Internal Revenue Service

The Internal Revenue Service has no mandate to regulate charitable solicitations as such, but it does have some tools to deal with flagrant abuses. These tools – audit, treating unreasonable fund-raising arrangements as "private inurement," making information available, and public warnings – have not been frequently used. We recommend below that new legislation be enacted to regulate solicitations. Meanwhile, the role of the Service remains important, particularly since the general public may regard recognition of exempt status by the Service as a certification of a public charity's continuing reliability.[301]

Audits

Since 1969 the Service has audited an average of about 2,000 public charities per year, only 2.5 percent of the 80,000 public charities that filed returns with the Service in FY 1973. The Service apparently assumes, judging from informal discussions with several officials and the relative neglect of public charity audits, that public charities are either large, reputable, and well-conducted or else too small to warrant increased attention. The assumption may be valid with respect to charitable operations generally but it does not seem warranted with respect to solicitations.

Disqualification for Excessive Fund-Raising Costs

The Service's *Tax Audit Guidelines – Exempt Organizations* directs revenue agents examining 501(c)(3) organizations to determine whether the expenses of a fund-raising activity "are proper and not excessive" and whether "the proceeds are being distributed for exempt purposes."[302]

The Service's Audit Division, however, has taken the position that a public charity spending 80 percent of its receipts for fund-raising costs, 10 percent for overhead, and only 10 percent for program purposes continues to qualify under section 501(c)(3) because, "There is no rule in the federal tax law that has as a bar to qualification for exemption a certain amount or certain percentage of fund raising for expenses."[303] The quoted statement is accurate in general, but in such extreme cases the Service could regard excessive compensation as transforming an organization's principal activity into a joint venture that triggers the "private inurement" disqualification of section 501(c)(3).[304] The Service disallows taxpayer "business expenses" that it regards as excessive. One problem may be that disallowance of a "business expense" results only in additional tax; disqualification of a fund-raising cost could lead to the more drastic remedy of revocation of exempt status. We discuss the problem of remedies at pages 2653 and 2657-58 below.

Public Information

The critical problem is lack of access by donors to reliable information about donees. Disclosure is the core of our recommendations below; the problem cannot be solved by the Service, at least not without substantial changes in budget and operations, but some progress is possible.

The Internal Revenue Service is directed by Code section 6104(b) to make the annual information returns of 501(c)(3) organizations available to the public "at such times and in such places" as the Commissioner may prescribe. The Service presently requires those requesting such returns to appear in person at the office of the District Director of the district where the organization's principal place of business is located (or at the National Office in Washington or the Philadelphia Regional Service Center), fill out a form, await notification as to when the return will be available for inspection (often weeks later), come back to the Service's office to inspect the return in the presence of a Service employee, and pay a duplication fee for any copies.[305] Furthermore, Form 990 returns are usually not available for one or two years after they are filed; many are several years older due to delinquent filing, thus limiting the usefulness of even the most current return available.[306] The Service included on Form 990 for 1973 a question designed for the first time to elicit fund-raising expenses, but no accounting standards have been prescribed for determining such expenses. (We discuss below at pages 2656-57 the need for uniform accounting standards).

Budget restraints may account in part for the Service's limited use of its §6104 authority. Attitudes conditioned by a justifiable preoccupation with the secrecy and confidentiality of tax returns generally may also be relevant. But there is a strong public interest in and need for the information; even taking budget problems into account, the present procedures seem designed to frustrate rather than facilitate access to information. We believe the Service should make the returns available in a more convenient way.

Public Warnings

The Service has procedures for warning the public of misleading solicitations and advertisements in fund-raising activities of particular organizations.[307] To its credit, in view of the potential for misuse, the Service has used these procedures sparingly. Nonetheless, these warnings are now issued only to correct misleading statements about the deductible portion of tickets, and so forth. The Service might similarly warn the public of other varieties of "flagrant disregard of the law or regulations" by soliciting organizations.

Pending Proposals for Federal Legislation

Two proposals for federal regulation of charitable solicitations are pending: H.R. 1123, originally introduced in the last Congress (then as H.R. 11991) by Representative Van Deerlin and reintroduced by him on January 14, 1975, referred to the Committee on Interstate and Foreign Commerce; and the proposed Truth in Contributions Act introduced on March 12, 1975, by Senator Mondale as S. 1153 in the Senate (referred to the Committee on Finance) and by Representative Karth as H.R. 4689 in the House (referred to the Ways and Means Committee).

H.R. 1123

H.R. 1123 would require persons making interstate charitable solicitations to provide specified information to any recipient of the solicitation who so requests, in writing, within 180 days after receiving the solicitation. The information would have to be provided within 30 days after the request was received.

Section 3 of the bill would require soliciting organizations – with important exceptions – to affix the following statement to all solicitation material, in a conspicuous place and in conspicuous type: " Recipients of this solicitation may receive pertinent information about it and the person making the solicitation by sending a request and a self-addressed, stamped envelope within one hundred eighty days after receipt of this solicitation to [insert the name and address of the person making the solicitation]."

Unfortunately, the exceptions, set forth in section 2(b)(1), include all 509(a)(1), (2) and (3) organizations,[308] that is, all public charities except those exclusively testing for public safety, thus exempting virtually all soliciting organizations from the notice requirement of section 3.

Section 4 prescribes the information that would be required to be provided, upon request, by all persons making interstate charitable solicitations (including those excepted from the notice requirement), as follows:

> (1) the name and principal address of the person making the solicitation;
>
> (2) the general purpose or purposes for which the person referred to in paragraph (1) is organized and operating;
>
> (3) the general purpose or purposes for which the contributions solicited shall be used by the person referred to in paragraph (1);
>
> (4) the financial terms of any contract or agreement between the person making the solicitation (or his agent) and the person on whose behalf the solicitation is made (or his agent) which in any manner –
>
>> (a) bases the amount of receipts received by the person on whose behalf the solicitation is made on the amount or number of contributions received from the solicitation; or
>>
>> (b) bases the fee or other charge of the person making the solicitation on the amount or number of contributions received from the solicitation;
>
> (5) the total income and total expenditures of the person referred to in paragraph (1), including a listing of the kind and amount of contributions received for charitable purposes and expenditures made with respect to solicitations for contributions for charitable purposes (including administrative and managerial costs attributable to such solicitations), with respect to the most recent fiscal year of such person for which there is an audited financial statement or financial statement sworn to by an officer of such person, or,

where such person is in existence for less than twelve calendar months, then with respect to a projected fiscal year including the period encompassing the duration of such solicitation;

(6) whether the contribution being solicited is deductible for Federal income tax purposes under the Internal Revenue Code of 1954;

(7) the names and addresses of the trustees, directors, officers, and other individuals responsible for the custody and final distribution of contributions received from such solicitation; and

(8) any other information which the Secretary of Commerce determines is necessary or appropriate to carry out this Act.

The Secretary of Commerce would be authorized to prescribe rules to carry out the act. Violation of the proposed act, or providing false information, would be a felony, punishable by a fine of not more than $25,000 or imprisonment for not more than two years, or both.

The bill provides no authorization for an appropriation nor does it provide any administrative machinery for enforcing the bill beyond the mandate to the Secretary of Commerce to prescribe rules.

The bill does not authorize any remedies except criminal penalties, apparently foreclosing equitable relief to enjoin organizations from soliciting or requiring them through mandatory injunction to provide information.

The bill does not provide specifically for uniform accounting standards, although presumably the Secretary's authorization to prescribe rules would extend to accounting rules. (As we discuss more fully below, uniform accounting standards are essential to disclosure. The development of such standards will require sustained effort.)

Truth in Contributions Bill

The proposed Truth in Contributions Act is based on information developed during the 1974 Hearings of the Subcommittee on Children and Youth of the Senate Committee on Labor and Public Welfare. It would amend the Internal Revenue Code by requiring certain public charities to distribute at least 50 percent of their gross revenue each year for charitable purposes, to include additional information in the annual returns they now file with the Internal Revenue Service, to file and make publicly available annual reports similar to those filed by private foundations, and to file with the Internal Revenue Service and furnish to each solicited person a "disclosure statement" containing specified information. No such disclosure statement could be used unless approved (or not disapproved within 30 days after filing) by the Internal Revenue Service.[309] Compliance would be enforced by penalty taxes similar to those imposed on private foundations under chapter 42.

Section 2(b)(2) of the act, defining "public charities" subject to the act, would specifically exclude all organizations described in Code sections 170(b)(1)(A) (i), (ii), (iii), (iv), (v), and (vii). Organizations thus excluded from the act's application include churches, educational institutions, hospitals and medical research organizations, governmental units and private foundations, and organizations whose purpose is to "receive, hold, invest and administer property and to make expenditures to or for the benefit of a college or university." Only organizations described in Code sections 170(b)(1)(A) (vi) and (viii) would be subject to the act, that is, those receiving a substantial part of their support from the general public or from governmental units and those organized to support such organizations. Also, any organization otherwise subject to the act is excluded from coverage for any year in which it has less than $25,000 gross revenue.

Section 2(d) of the act would require the annual information returns filed with the Service by such public charities to include (1) a statement of gross revenue for the year, on a fund-accounting basis, distinguishing between restriced and unrestricted sources of revenue; (2) a statement of total expenses for the year, reported on a functional basis, distinguishing between program costs, administrative and fund-raising expenses, and other categories prescribed by the Service; (3) a statement of analysis of functional expenses; (4) a balance sheet; and (5) such other information as determined by the Service to be "necessary to inform prospective contributors of the activities and fiscal policies of the public charity." The information return would be required to include a statement by a certified public accountant that the return had been prepared in accordance with accounting principles and standards to be prescribed by the Service.

Under section 2(e), public charities would also be required to file annual reports with the Service including (1) a copy of the prior year's information return, (2) the names and amount of compensation paid to its 10 most highly compensated officers or employees and to each employee or consultant paid more than $20,000, and (3) such other information as the Service may require. These annual reports would be required to be prepared by a certified public accountant in accordance with the accounting principles or standards to be prescribed by the Service; copies would be filed with appropriate officials of all states in which the charity solicits contributions and also be available for public inspection at the principal office of the organization during regular business hours by any individual who requests it.

Section 2(e) of the act would also require organizations subject to the act to file a "disclosure statement" with the Service at least 30 days prior to using such statement in soliciting contributions. Public charities would be required to furnish a copy of the disclosure statement to all persons from whom contributions are solicited, at the time of such solicitation, without regard to whether the solicitation is conducted in person, by mail, by broadcast, by publication, or otherwise. However, the disclosure statement could not be used unless it has been approved by the Service or has not been disapproved within 30 days after submission to the Service. The Service would disapprove disclosure statements that do not comply with regulations to be prescribed by the Service governing their contents. A copy of the most recent disclosure statement would be mailed by the public charity to any individual who requests a copy, within 15 days after receipt of such request, and would be furnished to the officials to whom the annual report is furnished.

A disclosure statement would have to contain (but is not limited to) (1) a statement of gross revenue for the year covered by the annual report; (2) a statement of the amounts expended during the year, and the percentage of gross revenue represented by such expenditures, for charitable purposes, fund-raising expenses, and administrative costs; and (3) such other information as the Service may prescribe.

Section 2(a) of the act would amend chapter 42 of the Code to impose two levels of penalty taxes on public charities which do not, within 12 months following the close of the year in question, distribute at least 50 percent of their gross revenue for the year for charitable purposes. The tax is not to be imposed for the first four years after enactment of the act, nor during the first four years of operation of newly created charities. Distributions qualifying to meet the 50 percent test would be defined, under accounting principles or standards to be prescribed by the Service, to include (1) expenditures for "the active conduct of the activities constituting the purpose or function for which the public charity is organized and operated"; (2) acquisition of assets directly devoted to such active conduct; and (3) transfers to other public charities (with safeguards to prevent the transfer of the same amounts back and forth to avoid penalty tax). Amounts obligated for specific projects would be treated as expended for charitable purposes if actual expenditure would be so treated and if the entire amount obligated is to be expended within five years and the project is of a nature which is best accomplished by the obligation rather than by immediate expenditures. Expenditures for office facilities or other administrative expenses, for fund raising, or for wages or salaries (except for those persons "engaged personally in performing services provided under a charitable program carried out by a public charity") would not be considered to qualify as expended for charitable purposes under the 50 percent test.

For any year in which the organization did not meet the 50 percent test, a two-level tax would be imposed: (1) an initial tax of 15 percent of the amount that should have been distributed to meet the 50-percent-of-revenue test; and (2) a second-level tax of 100 percent of the amount still undistributed if corrective action had not been taken within 90 days after receipt of a deficiency notice with respect to the original violation.

Tax penalties of $10 per day (maximum $5,000) would be imposed on the persons responsible without reasonable cause for failure to file a public charity's annual information returns, annual reports, or disclosure statements on time. For willful failures, including willful failure to issue to all prospective contributors at the time of solicitation an approved disclosure statement (or one that has not been disapproved within 30 days after filing), a penalty of $1,000 would be imposed.

Section 2(b)(1) of the act would apply to public charities provisions on termination of public-charity status that are similar to those now relating to termination of private-foundation status. Voluntary termination of public-charity status would be permitted upon notice to the Service and payment of a "termination tax" equal to either the "aggregate tax benefit" (the total amount of taxes that would have been collected from substantial contributors and from the charity had the charity not been tax exempt, plus interest to the date of termination) or the value of the public charity's net assets, whichever is lower.

Status as a public charity could be involuntarily terminated by the Service if the charity or its officers committed willful repeated violations (or committed a willful and flagrant violation) of the 50-percent-of-revenue test for charitable expenditures resulting in imposition of the penalty taxes described above, and if the Service, after consultation with the U.S. Attorney General with respect to the duties of the Attorney General under section 4 of the act, determined that such termination is "appropriate and in accordance with the purposes" of the act. Under section 4, the Attorney General, upon notification by the Service that an involuntary termination of public charity status was under consideration, would have to take "whatever action may be necessary to insure that assets consisting of, or derived from, contributions solicited from the public are preserved and expended only for substantially the same charitable purposes as those for which they were contributed." The Attorney General would be required to carry out this provision by seeking voluntary compliance and, if necessary, by instituting civil actions for appropriate relief in the federal district court where the charity is soliciting contributions or has an office. Upon a proper showing that such public charity "is engaged, or is about to engage, in acts or practices which would cause the dissipation of such assets or their diversion to noncharitable purposes (or to significantly different purposes)," an injunction or other order would be granted without bond by the court.[310]

Section 6 of the act would make it a crime, punishable by a fine up to $5,000 or imprisonment for not more than one year, or both, for any officer or employee of a public charity to knowingly commit any act or series of acts resulting in the involuntary termination of the organization's public-charity status.

Under section 5, any organization registered with the Advisory Committee on Voluntary Foreign Aid would be prohibited from stating that it is so registered in solicitation material distributed to the public. Violations would be penalized by a fine of up to $1,000 for the organization and for any officer or director who causes or consents to such violation, with the latter subject also to imprisonment for up to one year.[311]

Some Comments on These Proposals

If the press obtained and monitored the required disclosures, the Van Deerlin bill might be likely to expose the worst abuses. And it would undoubtedly be helpful for the limited number of sophisticated donors who could be expected to request information.[312] But unlike the proposed Truth in Contributions Act, it would not provide most donors with information at the critical time – when they receive the solicitation and decide whether to respond. Because charitable appeals often have emotional overtones, the techniques of some fund raisers are questionable, and many donors are unsophisticated, we believe that the proposals in H.R. 1123 – although helpful – are insufficient.

Moreover, federal regulation of charitable solicitations will require adequate funding and staff, both of which should be dealt with in the enabling legislation.

Lack of flexible remedies is a drawback in both proposals. The Van Deerlin bill provides only criminal penalties. The Truth in Contributions Bill, although not so limited in this respect and more effectively framed in numerous other respects as well, relies primarily on tax penalties (like the private foundation provisions of Code chapter 42 on which it is largely modeled). Neither proposal provides equitable remedies to enjoin solicitations or to mandate disclosures.

The Truth in Contributions Bill would provide disclosure at the critical time, and the requirement for prior submission of the disclosure statement to the government should help to assure meaningful disclosure. The principal defects of the Truth in Contributions Bill, in our view, are the 50 percent pay-out provision and the use of penalty taxes as sanctions.

Reliance on mandatory disclosure, without substantive rules such as the pay-out provision, seems more consistent with traditional federal regulation in analogous areas. It would interfere less with private conduct, requiring that donors be adequately informed before making their decisions but leaving both charities and donors with the flexibility and the responsibility to make their own well-informed choices among otherwise unrestricted alternatives. It would also be simpler to administer; experience under the Tax Reform Act of 1969 suggests that it would be time-consuming and expensive to determine what distributions qualify under the 50 percent test. Moreover, although the 50 percent limit is intended to discourage excessive administrative and fund-raising costs, it may become a negative incentive for the many charities whose non-program costs are much lower than that. For both philosophic and practical reasons, we thus prefer to rely on full disclosure to correct abuses, rather than on governmentally prescribed pay-out requirements.

The two levels of penalty taxes are in fact civil fines for disobeying the law (as are the current chapter 42 taxes in many respects). Despite the precedent of chapter 42, it seems to us wrong to burden the Internal Revenue Code with such fines. The tax sanctions also penalize charitable beneficiaries by further reducing the funds available for charitable programs, which is ironic since the tax would only be imposed on organizations already spending too little for such programs.

Finally, if a new regulatory function is to be lodged in an existing department, the Department of Treasury or of Justice (or perhaps the Federal Trade Commission) would seem preferable to the Commerce Department as proposed by the Van Deerlin bill or to the Internal Revenue Service as proposed by the Truth in Contributions Bill. The Commerce Department has no functions relating to exempt organizations and has few, if any, basic enforcement responsibilities. While assigning this function to the Internal Revenue Service may be logical if regulation is to be structured upon tax sanctions, as in the Truth in Contributions Bill, we think, as noted above, that tax sanctions are an undesirable enforcement mechanism and that other factors discussed below also weigh against assigning this additional function to the Service.

A Recommendation for Federal Regulation of Charitable Solicitations and Professional Fund Raisers

We recommend that a new agency be established within the Department of Treasury (or alternatively within the Justice Department) to regulate interstate charitable solicitation by compelling full disclosure to contributors when they are solicited and by prohibiting fraudulent solicitation practices. The scope of coverage would be carefully designed to exempt small solicitations, where the expense of compliance would be burdensome, as well as essentially private, membership, and church solicitations.

The new agency would be authorized to compel disclosures in a manner similar to that provided in the Truth in Contributions Bill, but it would not be authorized to regulate the substantive conduct of solicitations or the relationships between charitable organizations and the professional fund raisers employed by them. The premise is that if soliciting organizations provide full disclosure concurrently with a solicitation, and if fraudulent practices are prohibited, the market place can decide substantive questions such as how much should be spent for fund raising.

Full disclosure is also the premise of the securities laws and of the Interstate Land Sales Full Disclosure Act;[313] it seems useful to draw upon experience with those laws because, in many respects, the positions of the investor or purchaser and the donor are similar. The analogy should not be overstated; solicitations are a small enterprise compared with publicly traded securities and real estate development sales; but we have found it helpful to use the securities and land sales disclosure laws as a starting point in developing our proposal. The new agency would be authorized to obtain injunctive and similar equitable relief to compel disclosure and prevent or stop fraud.

Location of the New Agency

We see these three practical alternatives:

First, the functions of the new agency might be lodged with the Internal Revenue Service;

Second, the new agency might be an independent regulatory agency along the lines of the Securities and Exchange Commission;

Third, the new agency might be established as a bureau or service within the Department of Treasury (like the Customs Bureau and the Internal Revenue Service) or the Justice Department (like the Immigration and Naturalization Service).

We prefer the third approach. This was the alternative chosen in assigning administration of the Interstate Land Sales Full Disclosure Act to the Department of Housing and Urban Development, where it is headed by an administrator equivalent to an Assistant Secretary.

We see no logical reason to combine disclosure requirements with functions now performed by the Internal Revenue Service. The Service has no present functions similar to the disclosure and anti-fraud functions here proposed for the new agency. That the Service presently deals with exempt organizations in one context provides no warrant for assigning to it all regulatory functions with respect to such organizations, any more than the Service's experience with business transactions and finance has warranted assigning antitrust or securities regulatory functions to the Service. Indeed, the Service's valuable objectivity and impartiality in the vital rulings and determinations areas might be subtly affected if the Service simultaneously undertook to police solicitations practices of the same exempt organizations.

A sizable staff – perhaps as many as several hundred persons – is likely to be required to regulate solicitation disclosures.[314] It would be no easier to engraft such a staff on the Service than to establish it separately. Moreover, the status of the proposed functions would be reduced by assigning them to an administrative unit under an organization which is itself merely a bureau or service under the Treasury Department. We propose that the new agency be established as a bureau or service on the same level as the Internal Revenue Service. Responsibility to more than one federal agency would impose no undue burden on charities. The data required to be disclosed may overlap in some respects with data collected by the Service, but in many respects it will be different; most business firms are obliged to respond to several agencies.

Finally, the Service is currently reorganizing its administration in the exempt organization area under the new Assistant Commissioner as mandated by very recent legislation. This includes a deliberate effort by the Service to reorient its approach from traditional tax collection objectives. New lines of authority and new organizational loyalties are in the midst of being forged. It could place a severe administrative strain on the Service to undertake the substantial new responsibilities proposed for regulating solicitations, concurrently with the reorganization efforts already in progress. In this respect consideration should be given also to the budgetary and personnel requirements of the data dissemination program recommended below (pages 2661-64) under the Service's present statutory authority.[315]

The choice between a new bureau or service within the Department of Treasury and an independent regulatory agency is less clear. Regulatory and quasi-adjudicatory responsibilities are normally entrusted to independent agencies, such as the Securities and Exchange Commission, but they have also been entrusted to agencies within the executive branch, such as the Food and Drug Administration (part of the Department of Health, Education and Welfare), the Comptroller of the Currency (Department of Treasury), and the Interstate Land Sales Administrator (Department of Housing and Urban Development).

Some may prefer an independent regulatory agency on the ground that federal regulation, even though limited to disclosure, will impinge on sensitive areas in which organizational independence from the executive branch may be helpful. Independent agencies may not, however, be much more independent of the executive branch than agencies lodged within Cabinet departments, and they are likely to be less independent of the Congress.

Operationally, it is likely to be quicker and more economical to establish the new agency as a bureau within the Treasury, headed by a commissioner appointed by the President and confirmed by the Senate. Placing the new agency within Treasury should also facilitate cooperation with the Service and provide, through the Secretary, greater support within the government.

Scope of the Disclosure Regulation

As noted above, H.R. 1123 would apply to all charitable organizations, including churches, although the provisions for announcing availability of information would apparently apply to very few. The Truth in Contributions Bill would apply only to publicly supported charities and their support organizations, having annual gross revenue of at least $25,000, specifically excluding churches, educational institutions, hospitals and medical research organizations. Its sponsor, Senator Mondale, noted that the bill as introduced aims only to cover the kinds of organizations whose operations were studied by the Subcommittee on Children and Youth, and that broader coverage deserves consideration.[316]

The CBBB Standards for Charitable Solicitations excludes from its definition of charitable solicitations "an appeal conducted by a church, fraternal, civic, professional or training group or any other organization, if the appeal (1) is confined and directed exclusively to the organization's voting membership; (2) is an invitation to such membership or (3) is a request for support without any charitable purpose associated with the appeal."

Model state legislation to regulate charitable solicitations, prepared on behalf of the CBBB,[317] exempts from its definition of charitable organization, "any constituted religious organizations or any group affiliated with and forming an integral part of such organization . . ."

All interstate charitable solicitations (defined broadly) and all those making use of the mails should be subject to disclosure requirements, with the exception of specifically enumerated exemptions. Obvious exemptions to be considered relate to size, religious organizations, intra-membership solicitations, and solicitations that are essentially private.

Size. The requirement that federal regulation apply only to interstate solicitations and those conducted by use of the mail does not by itself impose any limitation based on size. The smallest solicitation originating in the District of Columbia is likely to cross the Virginia and Maryland lines; a solicitation originating in New York will surely cross New Jersey and Connecticut lines even if local in character. Abuses can of course occur in small solicitations, but they are not apt to be of a magnitude sufficient to warrant federal attention. Moreover, the administrative expense of complying with federal regulation becomes more onerous as the size of the solicitation decreases. We therefore believe that legislation creating the new agency should empower it by regulation to exempt charitable solicitations that seek to raise relatively small sums of money for organizations that have relatively small budgets.[318]

Membership solicitations. An appeal confined exclusively to the membership of an organization, for the programs of that organization, should be exempt, with suitable safeguards to be sure that the exemption is not used as a way of avoiding regulation.

Private solicitations. Just as the securities laws and regulations exempt private offerings of securities, so should essentially private solicitations be exempt. Exemption could be drawn in terms of the number of persons solicited and the means of solicitation.

Churches. Requiring disclosures from churches and their integrated auxiliaries raises special constitutional and policy questions which we do not attempt to resolve here. Although the normal fund-raising activities of established churches presumably raise no problems, abuses have occurred among affiliates of some religious organizations. One religious organization reportedly devoted 100 percent of its direct mail solicitation receipts for two years to building up a contributors list; some others have had only tenuous connection with religious activities and apparently spend most of their receipts on direct mail solicitation costs.[319] About 35 percent of the inquiries received by the CBBB from solicited persons relate to mail solicitations received from religious organizations.

The Internal Revenue Code recognizes the special character of religious organizations. Churches, their intergrated auxiliaries, and conventions or associations of churches need not file returns with the Service.[320] However, this restriction does not apply to other organizations which are merely affiliated with churches, and it does not impair the authority of district directors under Code section 6001, whenever in their judgment it is necessary in a particular case, to require a church upon notice to file a return and keep prescribed records to show whether it is liable for tax.[321] Also, the Service has authority to audit a church (or convention or association of churches) to determine whether it is in fact a church and whether it is liable for tax under the Code.[322]

Nature of the Disclosure Regulation

All persons making charitable solicitations subject to the disclosure rules should, we suggest, be required to include a solicitation statement with all solicitation material. The solicitation statement would contain material information pertaining to the solicitation and the organization making it, presented in a format prescribed by the new agency. The solicitation statement would be a separate document included in all mail solicitations, used in door-to-door solicitations, and so forth, but soliciting organizations would be free to use any literature, brochures, gifts, or other data in their solicitations (provided that it was not misleading) in addition to the solicitation statement.

Solicitation disclosure rules would also apply to telephone appeals and to solicitations through media advertising, although different procedures would be required to ensure that solicited persons received material information. In these cases, the rules might require that some information be provided at the time of the solicitation – by telephone, or in the text of a media advertisement – with a clear statement to the effect that a full solicitation statement is available upon request.

Before any solicitation could be made, the proposed text of the solicitation statement would be submitted to the new agency for review.[323] It could be used within a reasonably prompt time (30 days, for example, as proposed in the Truth in Contributions Bill) unless the new agency notified the soliciting organization that changes in the solicitation statement were required to comply with the disclosure rules.[324] The solicitation statement would be required to state that the filing of a solicitation statement did not constitute an approval by the new agency of the solicitation or the soliciting organization or verfication of the truthfulness of the information contained in the solicitation statement.

Organizations subject to the disclosure requirement would also be required to file additional information with the new agency, including annual reports containing audited financial statements and periodic data reporting major changes.

In all of the above respects, the proposed disclosure requirements are similar to – but less complicated than – rules under the Securities Act of 1933 and the Securities Exchange Act of 1934 and under the Interstate Land Sales Full Disclosure Act. These acts may provide useful precedents for many problems that will arise under the solicitation disclosure rules, for example, what is a solicitation and how is soliciting material distinguished from other literature distributed by a charitable organization.

What Should the Solicitation Statement Disclose

The disclosures prescribed in section 4 of H.R. 1123 and in the "disclosure statement" proposed by the Truth in Contributions Bill, set forth at pages 2648-49 and 2650-51 above, provide a good starting point for the disclosures required in the solicitation statement. The extent of the disclosures to be made – how extensively purposes and programs should be described, for example – can be developed through rules and practice.

Accounting Standards

A critical factor in any regulation of solicitations, particularly disclosure, is the need for uniform accounting standards. The Truth in Contributions Bill, but not H.R. 1123 expressly recognizes this.

In 1964 the National Health Council and its member agencies, and the National Social Welfare Assembly (presently the National Assembly for Social Policy and

Development) and its affiliated organizations, published "Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations" which are currently being revised with the additional sponsorship of the United Way of America. The Civil Service Commission requires these standards to be observed by charities eligible for soliciting federal employees. The current revision of the standards is intended to conform with "generally accepted accounting principles" prescribed for health and welfare organizations by the American Institute of Certified Public Accountants.[325]

Devising uniform standards applicable to all types of public charities is difficult, particularly the allocation of multi-purpose costs between fund raising and other functions.[326] In August 1974 the Internal Revenue Service for the first time included, as an optional criterion to be used by key districts in selecting exempt organization returns to be audited, the percentage of contributions spent on solicitation expenses,[327] but in the absence of uniform accounting standards there is no basis for comparability among exempt organizations. The Commission on Private Philanthropy and Public Needs' Accounting Advisory Committee has concluded that a single, uniform set of accounting principles, applicable to all philanthropic organizations, is feasible and should be adopted, including some 16 specific principles recommended by that committee.[328]

The Securities Act of 1933 and the Securities Exchange Act of 1934 authorize the Securities and Exchange Commission to define accounting terms and to prescribe

> the items or details to be shown in the balance sheets and earnings statement and the methods to be followed in the preparation of accounts, in the appraisal or re-evaluation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of consolidated balance sheets or income accounts of any person . . .[329]

Different language would of course be required, but the concept seems applicable here. In practice, the SEC has rarely exercised its extensive statutory powers to prescribe accounting practices. One observer explains the SEC's role as follows:

> For the most part it has been satisfied to let the profession lead the way in accounting and auditing progress. It is not surprising that the efforts of the profession itself and of the Commission should complement each other. For what is accounting, ideally, but full disclosure? The effect of the SEC statutes was to strengthen the hands of the better elements of the accounting fraternity in their own struggle with corporate management. On the whole, therefore, there has been a healthy interchange of views between the Commission and the profession. Regulation S-X [financial regulation] itself evolved not only from the Commission's decisions in particular cases but also from constant informal discussions with registrants, their individual accountants, and the professional societies.[330]

Without authority to prescribe accounting standards, and to require audited financial statements, the disclosure requirements of any legislation would have little or no value.

Anti-Fraud Provisions

A corollary of the requirement that material information be disclosed is the requirement that disclosures be truthful, that no material information be omitted, and that disclosures not be deceptive or misleading.

Rule 10b-5 under the Securities Exchange Act of 1934[331] makes it unlawful, in connection with the purchase or sale of a security,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.[332]

Virtually identical language was adopted in the Interstate Land Sales Full Disclosure Act, in connection with the lease or sale of lots in any real estate subdivision containing 50 or more lots.[333] A similar anti-fraud provision seems applicable to untruthful disclosures and other frauds in connection with solicitations subject to the proposed disclosure requirements. Such a provision would *not* apply to such abuses of self-dealing between trustees and a charitable organization; it would be limited to fraud *in connection with* solicitations.[334]

Remedies and Enforcement

The new agency should be authorized, as are the SEC and the administrator of Interstate Land Sales, to conduct investigations (including authority to subpoena documents and take testimony under oath), to take administrative action based on its investigations, and to seek and obtain injunctive and other equitable relief from the United States Federal District Courts whenever it appears that any person is engaged or about to engage in acts or practices constituting violations of the proposed act or of rules or regulations issued under it. For willful and flagrant violations, there should be criminal penalties.

Registration of Professional Fund Raisers

All professional fund raisers who engage in interstate charitable solicitations should be required to register with the new agency and provide financial and other information periodically. The purpose is to provide the new agency with a data base likely to be required in conducting investigations and determining whether there has been compliance with disclosure requirements.

The activities of professional fund raisers, including the terms of their arrangements with clients, would not be substantively regulated.

VII

JUDICIAL REMEDIES

Equity Enforcement Powers

Until 1969, the only compliance sanction available to the Service in supervising exempt organizations was revocation of exempt status. With no flexibility to take less drastic action, the understandable inclination is to reserve this "death sentence" for extreme situations. The Tax Reform Act of 1969 imposes excise taxes on violations of chapter 42 of the Code, but these apply only to private foundations. Revocation of exempt status is still the Service's only available enforcement remedy for public charities. Both revocation and chapter 42 excise taxes deplete the resources available for charitable purposes.

A much more comprehensive proposal for equity enforcement powers was recommended to Congress by the Treasury Department in 1969.[335] The Treasury proposal, although addressed only to private foundations, could apply as well to all 501(c)(3) organizations; it was also designed to accommodate the interest of the states in supervising charities.

As presented to the Ways and Means Committee in 1969,[336] Treasury's proposal recommended substantive standards with respect to self-dealing, adequacy of distributions for charitable purposes, and excess business holdings,[337] with two kinds of sanctions: (1) tax penalties, such as those enacted in chapter 42, and (2) civil suits in equity before U.S. District Courts, to be instituted by the Justice Department upon referral from the Service, in the name of the United States as plaintiff.

The Treasury Department proposed that U.S. District Courts be invested with equity powers to remedy any detriment to a charity resulting from violation of the substantive standards (including power to rescind transactions, surcharge trustees, and order accountings), to ensure that the organization's assets were preserved for charitable purposes, and to prevent recurring violations (including the power to substitute trustees, divest assets, enjoin activities, and appoint receivers). Once an equity action was instituted, the district court would also have exclusive jurisdiction to review any tax penalties imposed administratively by the Service. Equity powers would automatically be used to preserve charitable assets upon loss of exempt status.

The Treasury proposal provided that if state authorities instituted action before state courts to remedy violations, the U.S. District Court before which the federal action was pending would defer until the state court action was concluded. The district court could then take such further action, consistent with the state action, as was necessary.

The Treasury Department did not press its equity enforcement proposal in 1969 because, we understand, the Service and the Justice Department were unable to agree on who should represent the government in such litigation. Broad federal equity powers such as proposed by Treasury are essential to supplement the present sanctions of revocation or penalty taxes. Such powers would provide flexibility to fashion sanctions that meet the exigencies of the particular case without penalizing intended charitable beneficiaries by reducing the funds available for charitable programs. The provision to stay federal proceedings pending the conclusion of parallel state proceedings would defer appropriately to state authorities to the extent that they develop effective supervisory programs.

We assume that federal equitable remedies would only be used to enforce substantive standards provided by federal statute, rather than any broad common law of trusts and fiduciary responsibilities. The substantive standards now contained in the Internal Revenue Code consist basically of section 501(c)(3), which applies to all charitable organizations, and the special provisions of chapter 42 that apply to private foundations.

Prior to the Tax Reform Act of 1969, section 503 of the Code prohibited some 501(c)(3) organizations from engaging in certain self-dealing transactions with their creators. However, even then section 503 was inapplicable to religious organizations, schools and colleges, hospitals and medical research organizations, and publicly supported charities (section 170(b)(1)(A)(vi) organizations). The Tax Reform Act of 1969 repealed section 503, as it applied to any 501(c)(3) organizations, apparently on the ground that it was redundant in light of chapter 42.[338] The result was to subject private foundations to the more stringent provisions of chapter 42 but to leave all other 501(c)(3) organizations subject to no self-dealing restrictions whatever. This seems to have been inadvertent.

The present statutory scheme may be satisfactory, insofar as substantive standards are concerned, but some consideration should be given to the question whether public charities should be subject to federal prohibitions on self-dealing, either by restoring applicability of section 503 or by enacting some other provision such as that of section 4941 which restricts self-dealing by private foundations. While there are some indications that closer supervision may be needed in this area,[339] we have found virtually no data (apart from an occasional newspaper article) on the extent of self-dealing abuses among public charities; opinions on the subject varied widely among attorneys with whom we discussed the matter. Considerably more reliable information on this subject should be produced by the Service's Taxpayer Compliance Measurement Program (TCMP), which currently includes 3,500 public charities randomly selected by stratified sample (see pages 2610-11 above); one of the items to be evaluated in each of those special TCMP audits is whether such public charities would be in violation of the self-dealing restrictions of section 4941 if they were assumed to be subject to those restrictions, and if so, the total dollar amount involved.[340]

Regardless of the position taken on this issue, we believe that federal equitable sanctions should apply to all 501(c)(3) organizations. Even with respect to violations of the standards set forth in section 501(c)(3) itself, occasions arise frequently in which equitable relief rather than revocation would seem to be more appropriate.

Judicial Review of Adverse Status Determinations

To protect the tax system from premature judicial interference, the Code permits a suit in the Tax Court for review of a deficiency assessment or a suit in a U.S. District Court or the Court of Claims for a refund.[341] Section 7421(a) of the Code provides that apart from these procedures, "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court." Judicial review of Service decisions is thus available only after a tax has been assessed.

This works no unusual hardship for most taxpayers, but it creates a major problem for charitable organizations. Denial or revocation of exempt status, or failure to act on an exemption application, are not judicially reviewable even though they may destroy a charitable organization.[342] The organization may contest the denial of exempt status by earning a profit from operations and then contesting the income tax when it is assessed,[343] or it may find a donor willing to make a contribution, claim a deduction, and contest the disallowance of the deduction, but neither alternative is realistic. By the time such remedies could be used, the organization would have succumbed financially. Moreover, both remedies are circuitous and artificial.[344]

Addressing the adequacy of present remedies, the Supreme Court recently noted:

> In holding that §7421(a) blocks the present suit, we are not unaware that Congress has imposed an especially harsh regime on §501(c)(3) organizations threatened with loss of tax-exempt status and with withdrawal of advance assurance of deductibility of contributions . . . The degree of bureaucratic control that, practically speaking, has been placed in the Service over those in petitioner's position is susceptible to abuse, regardless of how conscientiously the Service may attempt to carry out its responsibilities. Specific treatment of not-for-profit organizations to allow them to seek preenforcement review may well merit consideration. But this matter is for Congress, which is the appropriate body to weigh the relevant, policy-laden considerations, such as the harshness of the present law, the consequences of an unjustified revocation of §501(c)(3) status, the number of organizations in any year threatened

with such revocation, the comparability of those organizations to others who rely on the Service's ruling letter program, and the litigation burden on the Service and the effect on the assessment and collection of federal taxes if the law were to be changed.[345]

Prompt judicial review of adverse 501(c)(3) rulings, failure to rule, or revocations would benefit the Service's administration of charitable organizations. The lack of judicial precedents deprives the Service of standards and guidance in deciding exemption issues that present innovative charitable concepts. As former Commissioner Thrower observed: "This is an extremely unfortunate situation for several reasons. First, it offends my sense of justice for undue delay to be imposed on one who needs a prompt decision. Second, in practical effect it gives a greater finality to IRS decisions than we would want or Congress intended. Third, *it inhibits the growth of a body of case law interpretative of the exempt organization provisions that could guide the IRS in its further deliberations.*" [Emphasis added][346]

Congress recently provided a right of Tax Court review of adverse Service determinations or failure to make a determination within nine months, with respect to the exemption qualification of the retirement plans under the Employee Retirement Income Security Act of 1974.[347] Commissioner Alexander has recommended that such judicial review be provided for 501(c)(3) determinations as well.[348]

We recommend a statutory right to judicial review for any organization denied 501(c)(3) status, or not granted such status within a reasonable time after application.

VIII

RECOMMENDED ADMINISTRATIVE ACTIONS WITHIN THE SERVICE

Dissemination of Data on Philanthropy

Lack of data is a major problem for philanthropy. We believe the Service should undertake to collect, analyze, and publish statistics about philanthropy; if it does not wish to do so, or is unable to obtain the necessary funds, the new agency recommended above (pages 2653-58) might assume responsibility. The Service requires no additional statutory authority to undertake the expanded information program here proposed.

> Code section 6108 directs the Service to "prepare and publish annually statistics reasonably available with respect to the operation of the income tax laws, including classifications of taxpayers and of income, the amounts allowed as deductions, exemptions and credits, and any other facts deemed pertinent and valuable."

The Assistant Commissioner (Planning and Research) now publishes substantial data, but not about exempt organizations.

The Need for Data on Philanthropy

Surprisingly little specific information is publicly available about charitable funds – who provides them, who spends them, and what they are spent for. The lack of information is striking, compared with the data published regularly by the Commerce and Labor Departments. It has been noted that lack of information may have affected consideration of the Tax Reform Act of 1969.[349] Commenting on lack of data, the Senate Subcommittee on Foundations recently stated that "neither

Congress nor the public can assess the amount of public benefit derived from the tax exempt status accorded foundations and other organizations."[350]

Lack of information deprives the Service, the Congress, and philanthropy of data on which appropriate regulatory measures may be fashioned. It impedes an informed allocation of charitable resources. It may contribute to misunderstanding by a public that already has some misgivings.

The Internal Revenue Service receives more data on philanthropy than any other institution, principally through the information returns filed annually by 501(c)(3) organizations and the annual reports filed since 1969 by private foundations. However, only limited portions of this data are currently entered into the computerized Exempt Organizations Master File (EOMF). Data have been computerized, and the EOMF has been programmed, primarily to serve internal needs rather than to provide useful data to the public. As a result, much of the data received by the Service is inaccessible.

There is no Service publication in the exempt organization field similar to the Statistics of Income series, which provides statistical analyses of data from income tax returns. (That series includes some data on charitable deductions reported by donors, but it is not sufficiently detailed or current to be useful.)[351] Few facts concerning exempt organizations appear in the Commissioner's annual reports.

The only available summary of data pertaining to contributions is *Giving USA*, published annually by the American Association of Fund-Raising Counsel. That publication, as the editors caution, provides estimates based on data provided voluntarily by a variety of private sources and several government agencies. In some areas such as education, substantial information is available; in other areas, very little. The information is fragmentary; it can produce only broad and highly imperfect extrapolations.[352]

Private efforts to compile data are also frustrated by the widespread preference of charitable organizations for privacy – what Waldemar Nielsen calls the "enclave mentality."[353] As noted earlier (page 2646), between 20 percent and 25 percent of soliciting charities refuse to respond to questionnaires of the Council of Better Business Bureaus or respond less than forthrightly.

We believe that the public responsibilities of charitable organizations, while properly carried out through private decision making, include openness to public disclosure. This is a concomitant to the special advantages of philanthropy and provides an important assurance against abuse of those advantages.

Categories of Data Needed

Data on philanthropy should be collected, analyzed, and published regularly. The need is to "gather data about all aspects of chairity, . . . issue publications periodically, and . . . provide information to the public on request."[354]

To determine what information is needed, how it should be organized, and in what format it should be presented requires further study by statisticians and the various organizations and interests affected. Some suggested categories of data include:[355]

(1) individual giving, permitting analysis of

  (a) average percentage of individual income given to charity at relative levels of gross income;

  (b) number of gifts and total dollar value broken down by size of gift (e.g., under $1,000, $1,000-$5,000, $5,000-$50,000, $50,000-$250,000, $250,000-$1 million, above $1 million);

(c) charitable donations by broad purpose, including at a minimum religion, education, health/hospitals, welfare/youth/recreation, arts and welfare, civic and public affairs, international activities, and gifts to foundations;

(d) separation of cash and noncash donations (separately for appreciated property), in total and in relation to the categories of size and purpose in (b) and (c) above;

(2) bequests, permitting analysis of annual amounts given, with detail for

(a) proportions of gross estate;

(b) cash and noncash (separately for appreciated property);

(c) by size of gift as (1)(b) above;

(d) by charitable purpose or objective as in (1)(c) above;

(3) foundation grants, permitting analysis of

(a) number of existing grant-making foundations and assets by type (general purpose foundations, corporation-financed foundations, community foundations and trusts, operating foundations);

(b) number of foundations added and dissolved annually, and amount of assets involved, by type of foundation;

(c) number of grants and total dollar value broken down by charitable purpose or objective, as in (1)(c) above;

(d) percentage of income and/or assets expended annually on grants and on administration;

(4) corporation giving, permitting analysis of

(a) total number of corporations, assets and industry classifications;

(b) number of corporations in categories set forth in (a) above that report charitable contributions;

(c) number of contributions and total dollar value broken down by charitable purpose or objective as in (1)(c) above;

(d) dollar value of corporate expenditures not listed as contributions but nevertheless of benefit to the public or to charities, e.g., support for cultural activities through public relations or advertising budgets, provision of free facilities to cultural exhibits;[356]

(5) public charity activities, permitting analysis of

(a) number of existing public charities by type (church, school, hospital/medical research organization, public safety testing, organization operated for benefit of public college or university, "publicly supported," supported by membership fees and receipts from exempt activities, operated solely in connection with one of the foregoing) and by net asset size for each type;

(b) purposes, activities, and objectives identified by principal IRS Activity Code entered on exemption application, for each type set forth in (a) above;

(c) gross income from contributions or gifts, investments, government grants or contracts, related business activities by type, unrelated business activities by type administrative or fund-raising expenses attributable to each of the foregoing, and taxes paid on unrelated business activities for each type and size of charity set forth in (a) above;

(d) charitable program expenditures, in total dollar amount and as a percentage of gross income, broken down by type and size of charity and by principal IRS Activity Code as set forth in (a) and (b) above;

(e) number of public charities added and dissolved annually, by type and asset size as in (a) above.

The Service's Role

The proposed data program should be undertaken by a government agency, so that complete and reliable data can be obtained.

The Service already has much of the data that should be analyzed and published; it also has computer facilities, data-collection procedures and a statistical publications program. With additional funding and staff, the Service could promptly begin publishing statistical data about philanthropy.

There are indications, moreover, that the Service may soon commence a more useful program in this area. Commissioner Alexander recently acknowledged that the previous policy may have "wrongly" neglected exempt organization data analysis.[357] A task force appointed by the Commissioner in 1974 proposed an improved exempt organization data program, which has already been reflected in a revised Schedule A to the 1974 Form 990 and in more extensive programming for computer analysis data reported on those returns. The Senate Subcommittee on Foundations has encouraged this effort by providing the Service with a list of information relating to exempt organizations, most of which is already received by the Service on forms filed annually,which the subcommittee believes "IRS should be collecting, analyzing and making available to the public."[358]

Such data could be disseminated in an annual report on philanthropy and in special reports, with perhaps some objective discussion noting trends in the data. We believe the Service should also publish data produced by its special TCMP-Exempt Organizations Program, much of which is unavailable elsewhere and highly pertinent to issues of philanthropic policy and oversight (see pages 2610-11 and 2659-60 above).

Specific Administrative Actions

We believe that the Service can improve its administration of exempt organizations in several respects; our specific suggestions are as follows:

Status Determination and Rulings

- The Service should request public comments when considering novel questions of exemption qualification (as it ultimately did with regard to public interest law firms) or major modifications of previous rulings that have wide impact. Notice and hearing may not always be required in such cases by the Administrative Procedure

Act, but public comments should provide useful information and supplement the Service's expertise.[359]

- The Service should be willing to provide advance rulings to exempt organizations when they are needed, even though such rulings may not fall within the general policies for issuing advance rulings. Private foundations, for example, are now unable to determine in advance whether the Service will acknowledge that a transaction is at fair market value despite the fact that the foundation may be subject to chapter 42 penalty taxes if the Service later challenges the terms of the transaction.

- Exempt organizations should be permitted to rely upon, as persuasive (although not necessarily conclusive) precedent, private-exemption rulings and determinations issued to other organizations. This would promote more equitable treatment of applicants and help to reduce the risk of inconsistent results among the seven regional offices reviewing exempt organization appeals (see page 2626 above).

Compliance Procedures and Practices

- The Tax Audit Guidelines issued in 1965 should be integrated with the Audit Technique Guidelines developed for training purposes after 1969, and updated to reflect current exempt organization audit policy.

- In view of their possible *in terrorem* effect, "No Change Advisory Letters" should be subject to protest and technical review (see page 2609 above).

- The audit program should not be concentrated so disproportionately on private foundations. Closer attention should be given to audit issues arising from compensated solicitation campaigns (see pages 2646-50 above) and self-dealing (see page 2660 above).

- Notices of proposed revocations of exempt status should advise organizations to address the issue of retroactivity separately in revocation proceedings; substantial grantors should be permitted to participate as interested parties in revocation proceedings.

- Field examination personnel should be authorized to give state authorities advance notice and more complete information in appropriate cases involving any exempt organization against which an adverse determination is in progress (see page 2619 above).

Personnel and Training

- Training materials for both the determinations and examinations functions of field personnel should be updated and should include material on the history, purposes, and public interest served by private philanthropy. The determinations and examinations courses might be combined into one course on supervision of exempt organizations, with participation by experts from outside the Service.

- The entry level for lawyers and professionals with similar training in the Technical Branch of the Exempt Organizations Division should be raised to equal the entry level for professionals entering the Chief Counsel's office and the Department of Justice.

Public Information

- The Service should sponsor seminars and educational programs throughout the country, to familiarize attorneys and others with the requirements of the Code, Service procedures, and the status of current Service issues relating to philanthropy. Particularly for small organizations, an information program would be extremely helpful.

- The most recently filed information returns and private foundation annual reports should be made available to the public under section 6104 by mail, upon written request, without the requirement for a personal appearance.

- Data relating to philanthropy and philanthropic organizations should be collected, analyzed and published by the Service as discussed at pages 2661-64 above.

Organizational Structure

- The Exempt Organizations Technical Branch should monitor carefully the decisions of regional offices upon appeals of adverse exemption determinations and penalty taxes, without reluctance to grant National Office review in any case presenting a reasonable question and regardless of whether the affected organization has specified such question in its appeal.

- We suggest that the Operations Branch of the new Exempt Organizations Division include separate sections for Private Foundation Examinations and Public Charity and Miscellaneous Examinations.

- The Office of Employee Plans and Exempt Organizations should have its own Planning, Research and Statistics Staff (see pages 2627 and 2661-64 above), with a capacity and readiness also to commission and publish studies relating to philanthropy by experts from outside the Service. Responsibility for the Exempt Organization Master File should be coordinated jointly between this staff and the Operations Branch of the Exempt Organizations Division.

- The Interpretative Division of the Chief Counsel's office should include an Exempt Organizations Branch, with increased staff at the review level.

- An effective procedure should be established for coordination between the Assistant Commissioner (Employee Plans and Exempt Organizations) and the Assistant Commissioner (Technical) to resolve differences between their respective technical staffs concerning interpretations of exempt organization Code provisions that are interrelated with provisions appearing in other areas of the Code. Such coordinating procedure should accord final responsibility to the Office of Employee Plans and Exempt Organizations when the difference arises over a rulings request that is required to be submitted under the Code's exempt organization provisions, such as requests for approval of foundation scholarship procedures required to be submitted under section 4945 (see page 2603 above).

Appendix

Number of Exempt Organizations, 1969-1974

Period[a]	Number of Private Foundations[b]	Number of Public Charities[a]	Total Active 501(c)(3)s[c]	Total Active Exempt Organizations[d]
3/31/74	28,326	174,186	226,122	--
FY 1973	25,133	--	220,074	643,586
FY 1972	23,172[e]	--	181,482	479,608
FY 1971	--	--	160,440	457,022
FY 1970	--	--	150,034	437,390
FY 1969	--	--	145,722	416,562

a. March 31, 1974, data from Commissioner Alexander's testimony, *Hearing Before the Subcommittee on Foundations, U.S. Senate Finance Committee*, June 3, 1974, pp. 115, 139; all other data as supplied by the Service. Public charities may generally be assumed to equal Total Active 501(c)(3)s less private foundations, but the 3/31/74 figures reported by Commissioner Alexander do not total, apparently because of 501(c)(3)s whose foundation status had not yet been determined. The Service advises that the number of 501(c)(3) organizations with such undetermined status was 10,852 as of June 30, 1974. Only about 80,000 public charities filed returns in FY 1973, with the balance of about 105,000 public charities (i.e., total active 501(c)(3)s less private foundations and those of undetermined foundation status) either delinquent or not required to file (churches and their affiliated auxiliaries, conventions or associations; subordinate units covered by a central organization's return; other public charities whose annual gross receipts do not normally exceed $5,000).

b. Does not include Nonexempt Charitable Trusts (NECTs) which are to be treated as private foundations. As of March 31, 1974, there were 7,726 NECTs which had filed required forms with the Service and are being treated as private foundations; the comparable figure for FY 1973 was 6,400.

c. The latest available figure, as of August 31, 1974, is approximately 230,000. All figures in this column omit organizations that have not applied to the Service for recognition, which is not required for churches (including their integrated auxiliaries and conventions or associations of churches), public charities whose annual gross receipts do not normally exceed $5,000, or subordinate units of public charities covered by group rulings issued to a central organization (which is counted as one entity in these figures). However, these figures include some organizations which, although not required to apply for recognition, have nevertheless done so; their number is unknown.

d. Includes subordinate units of parent organizations (other than religious organizations) to which group rulings have been issued. The substantial increase in the number of active entities for FY 1973 reflects a concentrated effort made during that time to add subordinate units to the EOMF listing.

e. This figure represents the total for the period ending July 31, 1972, as this was the first period that EOMF computer statistical data was available.

Footnotes

1. The Peterson Commission focused on private foundations, dealt with in the Tax Reform Act of 1969. See Foundations, Private Giving, and Public Policy, *Report and Recommendations of the Commission on Foundations and Private Philanthropy* (Chicago, 1970).

2. Only certain classes of business corporations were subject to earlier federal income tax statutes that were adopted briefly during the Civil War period. The 1894 statute was declared unconstitutional by the Supreme Court in 1895, *Pollock* v. *Farmer's Loan and Trust Co.*, 157 U.S. 429, aff'd on rehearing, 158 U.S. 601 (1895), but comparable provisions appeared in the Corporation Excise Tax of 1909 and then in the Revenue Act of 1913 and all revenue acts since then.

3. Other tax-exempt organizations include civic leagues and social welfare organizations, labor unions and agricultural organizations, chambers of commerce, recreation clubs, fraternal societies, teachers retirement associations, cemetery companies, credit unions and veterans organizations. See Internal Revenue Code §§ 501(c)(1) through 501(c)(19) and 501(d), (e) and (f). Qualified pension, profit-sharing and stock bonus plans, defined in Code § 401(a), are also given tax exemption by § 501(a). Also exempt are farmers' cooperatives (§ 521), shipowners' protection and indemnity associations (§ 526), political organizations (§ 527), common trust funds (§ 584) and charitable remainder trusts (§ 664).

4. Internal Revenue Code §§ 170(c)(2), 642(c), 2055(a)(2), 2522. Nonprofit veterans organizations also have this advantage, as do political organizations to a limited extent and some fraternal lodges for gifts to be used exclusively for charitable purposes; some nonprofit cemetery companies have this advantage with respect to income tax (but not estate or gift tax) deductions by donors. Organizations devoted to testing for public safety, although exempt under § 501(c)(3), do not qualify for deductible contributions.

5. We use terms such as "charitable organizations," "philanthropic organizations," and "501(c)(3) organizations" interchangeably; when we use the term "exempt organizations," we refer to all categories of exempt organizations. We use the term "public charities" to encompass all 501(c)(3) organizations that are not private foundations.

6. Charitable organizations also receive grants from and enter into contracts with government agencies: hospitals, for example, under the Hill-Burton Act; performing arts organizations under the National Endowment for the Arts; colleges and universities under Office of Education programs. Federal programs in areas such as education, manpower, health, civil rights, crime reduction, the environment, defense, space, research and development of all kinds — involving virtually the entire spectrum of the federal budget — include grants to and contracts with private institutions. A large (but unidentified) portion of the recipient institutions are 501(c)(3) organizations. The impact on philanthropy of the federal government's grant and contract activities is significant but beyond the scope of this study, which focuses on federal oversight of the collection and expenditure of *private* charitable funds. It should be noted, however, that a charitable organization's conduct of a substantial part of its activities under federal government grants and contracts may subject it to the same constitutional standards that are applicable to governmental agencies, at least in the areas of race and sex discrimination; see *New York City Jaycees, Inc.* v. *United States Jaycees*, Inc., 377 F. Supp. 481 (S.D.N.Y. 1974).

7. *Jackson* v. *Statler Foundation*, 496 F.2d 623, 638 (2d Cir. 1974) (Circuit Judge Friendly dissenting from denial of reconsideration en banc). See also Bittker, *A "Comprehensive Tax Base" As a Goal of Income Tax Reform*, 80 Harv. L. Rev. 925 (1967).

8. Internal Revenue Code [hereinafter sometimes referred to as "Code"] § 501(c)(3).

9. See Appendix, note 3.

10. Code § 7803(a).

11. Internal Revenue Manual [hereinafter cited as "IRM"] 1111.1 (1974); Rev. Proc. 72-57, 1972-2 Cum. Bull. 835, 836.

12. Remarks by Commissioner Randolph W. Thrower, prepared for delivery before South Dakota Society of CPA's and State Bar Association, Rapid City, South Dakota, November 6, 1970.

13. For this purpose, certain nonexempt charitable and split-interest trusts to which deductible contributions have been allowed are treated as 501(c)(3) organizations. Code § 4947. The exceptions to the application requirement of § 508 are discussed in note 32, infra.

14. Remarks by Commissioner Donald C. Alexander, prepared for delivery before the American Society of Association Executives, New Orleans, Louisiana, August 29, 1973.

15. Remarks by Commissioner Johnie M. Walters, prepared for delivery before Tax Exempt Organizations Institute, San Diego, California, January 12, 1973.

16. Reorganization Plan No. 1 of 1952, effective March 15, 1952, 1952-1 Cum. Bull. 227, has been embedded in the Internal Revenue Code of 1954, § 7804(a). Previously the Service was organized, both in Washington and in the field, on a program or "type-of-tax" basis, with jurisdictionally separate units administering different types of taxes.

17. See Rev. Proc. 72-2, 1972-1 Cum. Bull. 695.

18. See Rev. Proc. 72-3, 1972-1 Cum. Bull. 698.

19. Code § 7805(a).

20. See Rev. Proc. 72-1, 1972-1 Cum. Bull. 693.

21. See Code §§ 6213, 7421-7422; *Bob Jones University v. Simon*, 416 U.S. 725 (1974); *Commissioner v. Americans United Inc.*, 416 U.S. 752 (1974). Both the present Commissioner and at least one of his predecessors have proposed that Congress authorize direct appeal to the Tax Court, without awaiting notice of tax deficiency, from adverse decisions by the National Office on an organization's claim to exemption qualification.

22. Throughout Chapter II we discuss the Service's administration of exempt organization matters as it has existed up to December 2, 1974, when the Employee Retirement Income Security Act of 1974 became effective mandating certain changes in the structure of that administration. The nature and potential effect of those changes are reviewed in Chapter III. Apart from the specific developments noted in Chapter III, the discussion in Chapter II continues to be current as of mid-March 1975.

23. News Release IR-1326, August 29, 1973, Remarks of Commissioner Alexander prepared for delivery before the American Society of Association Executives, New Orleans, Louisiana, p. 5.

24. Under the Service's 1952 reorganization, an Exempt Organizations Branch was created in the National Office's Special Technical Services Division under the Assistant Commissioner (Technical). See Rev. Rul. 10, 1953-1 Cum. Bull. 488, 493.

25. Rev. Rul. 54-164, 1954-1 Cum. Bull. 88.

26. The 1969 report of the Commission on Foundations and Private Philanthropy ("Peterson Commission") had focused on the Service's inadequacies in this area.

27. Commissioner of Internal Revenue, *Annual Reports* 1970, 1969; Cohen, The Internal Revenue Service and Its Programs for Exempt Organizations, *NYU Proceedings of 9th Bien. Conf. on Charitable Foundations* 243, 245-247 (1969).

28. Remarks by Commissioner Randolph W. Thrower, prepared for delivery before the Southwestern Legal Foundation, Dallas, Texas, January 15, 1971; ibid., before the South Dakota Society of CPA's and State Bar Association, Rapid City, South Dakota, November 6, 1970. One of the Service's principal deficiencies even at the present time is its continued failure to analyze and publish exempt organization data other than that necessary to the computation of tax liability, thus frustrating analysis of the existing law's impact on charitable activities. See Testimony of Commissioner Alexander, *Hearing Before U.S. Senate Committee on Finance, Subcommittee on Foundations*, June 3, 1974, *passim*, and discussion at pages 2661-64 below.

29. Originally, the training program was to include "refresher courses in fields such as sociology, political science, economics, philosophy and the like." Remarks by Commissioner Randolph W. Thrower before American Bar Association Section of Taxation, Dallas, Texas, August 10, 1969. See also Commissioner of Internal Revenue, *Annual Report* 1969, p. 6: "Internal Revenue agents and other specialists assigned to exempt organizations work will be given special training beyond the scope of tax law and accounting — for example, basics of sociology, political science, and economics." The actual content of this training program is discussed at pages 2586 and 2603 below.

30. News Release IR-1010, January 19, 1970, "IRS to Centralize Tax Exempt Organization Activity."

31. Rev. Proc. 73-7, 1973-1 Cum. Bull. 753 (private foundations); Rev. Proc. 72-4, 1972-1 Cum. Bull. 706. See also Rev. Proc. 72-41, 1972-2 Cum. Bull. 820 (applications of central organizations for group rulings exempting subordinate organizations). Technical advice procedures are set forth in Rev. Proc. 73-8, 1973-1 Cum. Bull. 754.

32. Code §§ 508(a) and (c) except from this requirement all organizations that were organized prior to October 10, 1969, all churches (including their integrated auxiliaries and conventions or associations of churches), and all public charities whose annual gross receipts do not normally exceed $5,000. IRS by regulation also excepts subordinate public charity organizations covered by group exemption letters and "Nonexempt Charitable Trusts" which were organized prior to October 10, 1969. Treas. Reg.§ 1.508-1(a)(3). As a result of the exceptions from the application requirement, IRS acknowledges that under present law it "will never know" the total number of 501(c)(3) organizations. Testimony of Howard Schoenfeld, Audit Division, Internal Revenue Service, *Hearings Before the Subcommittee on Foundations of the Committee on Finance, U.S. Senate*, June 3, 1974, p. 137.

33. Treas. Regs. §§ 1.501(a)-1(a)(2) and 1.508-1(a)(4). Because of the advantages of recognition by the Service (see the following footnote), some church groups and small public charities that are excepted from the § 508 application requirement nevertheless choose to obtain 501(c)(3) recognition by the Service.

34. Treas. Publication 78. In addition, social security and unemployment taxes become optional rather than compulsory with respect to wages paid employees of organizations whose 501(c)(3) status has been recognized by IRS, see Code §§ 3121(b)(8)(B) and 3306(c)(8). Some small public charities and church groups that are not required to apply for Service recognition, and have not done so, are nevertheless listed in Publication 78 at their own request.

35. Code § 508(b) and (c). Note that pre-1969 organizations and small public charities are not excepted; section 508(c) requires that the latter *not* be private foundations in order to qualify for the exception of section 508(b).

36. If classified as a private foundation, the Service may also have to determine whether the organization is a private operating foundation under Code § 4942(j)(3).

37. The National Office's Technical staff also conducts, on a sample basis intended to assure uniformity of standards, a post-review of determination letters issued in the field. See section 9 of Rev. Proc. 72-4, 1972-1 Cum. Bull. 706, 708. This is estimated by IRS to occupy 5% of the time of Technical's Exempt Organizations Branch. No data are available on how often such post-reviews result in a National Office exception to field determinations; if such an exception is taken and the organization protests, the file is referred to the National Office for technical advice.

38. The analysis does not of course reveal how much time or effort may be required to obtain the results, nor the extent to which new organizations are effectively denied 501(c)(3) recognition by protracted delay. See page 2598 below.

39. Treas. Reg. § 1.501(c)(3)-1(d)(1)(iii).

40. The legislative history of section 501(c)(3) is discussed in Rev. Rul. 67-325, 1967-2 Cum. Bull. 113.

41. Treas. Reg. § 1.501(c)(3)-1(d)(2).

42. Ibid.; see also IRM 11(671).759.

43. See pages 2660-61 below.

44. Recently Commissioner Alexander noted that, "More than a legal decision has to be made. It is relatively easy to say that an activity furthers a charitable or religious or social welfare or even a common business purpose. It is far more difficult to decide whether, in point of fact, this or that activity really does further goals stated in such nebulous terms." News Release IR-1326, Remarks by Commissioner Alexander prepared for delivery before the American Society of Association Executives, New Orleans, Louisiana, August 29, 1973.

45. A few of the Service's own experts, uncomfortable with the interpretative judgment required of the Service in the exempt organizations area, would welcome comprehensive statutory treatment of the taxation of *all* categories of nonprofit organizations, leaving the Service simply with its familiar audit role as in the case of business organizations. They note, for example, that the Code's present provisions for determining "income" and "trade or business expenses" are not well designed for nonprofit organizations that are *not* found to be exempt.

46. Assistant Secretary of the Treasury for Tax Policy Edwin S. Cohen observed, "We have tried to avoid interpreting the word 'charitable' in a fixed, immutable fashion. As the courts have done in many nontax settings, we have tried to give it a meaning that changes and expands as the needs of society change and expand." *Statement Before the House Committee on Ways and Means, on H.R. 13720,* May 3, 1972.

47. See, e.g., Deposition of Arthur B. White, Special Assistant to the IRS Chief Counsel and Associate Chief Counsel (Technical), July 26, 1973, in *Center on Corporate Responsibility, Inc. v. Schultz*, Civil Action No. 846-73, U.S. District Court for the District of Columbia, at Tr.62: "There has been . . . concern in the office and in the Chief Counsel's office . . . that we're getting further and further away from judicial precedent in the social welfare area, what you referred to as an ideological area. There have been discussions even this year that we've got to tighten up on our precedents and see that we have very carefully reviewed the legal grounds of them."

48. IRM (11)671.759. Note that "promotion of social welfare" as a charitable purpose under 501(c)(3) is somewhat limited by the Regulation's provision that such promotion must be "designed to accomplish any of the above purposes [relief of poverty and distress; advancement of religion, education or science; erection of public buildings, monuments or works; or lessening the burdens of government], or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency." Treas. Reg. § 1.501(c)(3)-1(d)(2). However, under section 501(c)(4), "promotion of social welfare" is defined simply as "promoting in some way the common good and general welfare of the people of the community." Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

49. "The position of the Service is that the law of charities traditionally has recognized that private, nonprofit schools are educational and thus charitable, even though their enrollment is limited to a particular sex, a particular religion, or a particular race. There has been no decision of any Federal court of which we are aware that rejects this principle." Remarks of Commissioner Randolph W. Thrower before American Bar Association Section of Taxation, Dallas Texas, August 10, 1969.

50. *Green* v. *Kennedy*, 309 F. Supp. 1127 (D.C.D.C. 1970), on final injunction sub nom., *Green* v. *Connally*, 330 F. Supp. 1150, aff'd per curiam sub nom., *Coit* v. *Green*, 404 U.S. 997 (1971).

51. Remarks by Commissioner Randolph Thrower before American University Tax Conference on Non-Profit Organizations, Washington, D.C., February 18, 1971. See Rev. Rul. 71-447, 1971-2 Cum. Bull. 230. The Service's change of position was announced in July 1970, after issuance of a preliminary injunction in the *Green* case but before decision on the final injunction.

52. 330 F. Supp. at 1159-1160.

53. Rev. Proc. 72-54, 1972-2 Cum. Bull. 834.

54. Proposed Rev. Proc., Technical Information Release TIR-1347, February 14, 1975.

55. E.g., *Jackson* v. *Statler Foundation*, 496 F.2d 623 (2d Cir. 1974); *Falkenstein* v. *Department of Revenue*, 350 F. Supp. 887 (D. Ore. 1972) (three-judge court), app. dism., 409 U.S. 1099 (1973); *McGlotten* v. *Connally*, 338 F. Supp. 448 (D.C.D.C. 1972) (three-judge court).

56. See *New York City Jaycees, Inc.* v. *United States Jaycees, Inc.*, 377 F. Supp. 481 (S.D.N.Y. 1974).

57. The effects of the long delay are described in Adams, *Responsible Militancy – The Anatomy of A Public Interest Law Firm*, The Record of the Association of the Bar of the City of New York, November 1974.

58. Remarks by Commissioner Thrower, before American University Tax Conference on Non-Profit Organizations, Washington, D.C., February 18, 1971.

59. Testimony of Commissioner Thrower, *Hearings Before the Senate Subcommittee on Employment, Manpower and Poverty*, on Tax Exemptions for Charitable Organizations Affecting Poverty Programs, 91st Cong., 2d Sess. pp. 71-72, November 16, 1970.

60. Not until October 1974 did the Service issue its first private rulings on this matter, permitting public interest law firms to accept fees awarded by a court or provided by a court-approved settlement, but only where the probability of recovering a fee is not so strong as to make the litigation economically feasible for private law firms; in no case may fees (however small) be accepted from clients, and no more than 50 percent of the organization's litigating budget may be defrayed by awarded fees (based on a five-year moving average). The latter two conditions remain the subject of continuing controversy. The Service has lately adhered to its position, see Rev. Proc. 75-13 and Rev. Rul. 75-74, 75-75 and 75-76, 1975 Int. Rev. Bull. No. 10, March 10, 1975.

61. The key districts were increased to 19 from 16 in December 1974 as part of the reorganization incident to creation of a new Office of Employee Plans and Exempt Organizations. See Chapter III. Applications received by IRS offices abroad are referred to the Office of International Operations in Washington, whose director functions as a key District Director for such organizations.

62. A few key districts do not establish formally separate groups for the two functions.

63. Rev. Proc. 72-4, 1972-1 Cum. Bull. 706, 707. The standard was the same under the earlier procedure, Rev. Proc. 69-3, 1969-1 Cum. Bull. 389.

64. IRM (11)671.221-222. Also to be referred to the National Office are group exemption applications and private school cases in which (a) adverse action is a probability, (b) the case arises from Mississippi, or (c) the school's principal method of publicizing its racially nondiscriminatory policy is not one of those approved by the Service's Revenue Procedure on this subject. IRM (11)671.223-224.

65. IRM (11)671.224.2.

66. No breakout of 501(c)(3) from other exemption applications is available. As distinct from rulings, the National Office in recent years has issued "technical advice" in about 500 cases annually, including adverse district determinations protested by applicants and proposed revocations.

67. The Commissioner's *Annual Reports* for 1971, 1972 and 1973 each show about 3400 rulings (as distinct from technical advice) issued on exempt organization matters. The Service advises that about half of these rulings are on 501(c)(3) applications, about 30% are on requests by private foundations for rulings on proposed transactions (of which by far the largest number involve procedures for individual grants and scholarships, for which advance IRS approval is required under Code § 4945(g)), and the remaining 20% are on applications for exemption under other Code provisions and other matters.

68. Lehrfeld and Webster, *Administration by the IRS of Non-Profit Organization Tax Matters*, XXI Tax Lawyer 591, 598 (Spring 1968).

69. Exemption applications increased from 17,361 in FY 1966 to 29,741 in FY 1973.

70. Rev. Proc. 72-4, 1972-1 Cum. Bull. 706; IRM (11)671.250 and Exhibit 200-18 thereto. Treasury Publication 716 ("Instructions for Preparing Protests of Determination Letters Issued to Organizations Claiming Exemption Under Section 501 of the Internal Revenue Code") is normally attached to adverse determination letters, unless the letter itself contains such information.

71. See the sample denial letter shown as Exhibit 200-18 to IRM (11)671.250. However, upon issuance of an adverse determination the file is placed in suspense for 45 days, during which no action is taken to obtain tax returns or any tax payment "unless the interests of the Government are in jeopardy," and a protest received after 30 days "will be considered"

although "reopening of the case will be coordinated with any action in process, such as efforts to obtain income tax returns, examination of returns, or court or appellate action." IRM (11)671.261.

72. District conferences may be conducted as necessary at locations other than the key district office by "circuit rider" conferees from key districts. IRM 4(11)81.

73. The absolute right to National Office review of adverse determinations is now being modified by the establishment of a Regional review level under the new Assistant Commissioner discussed in Chapter III. See pages 2623, 2626 below.

74. If the written protest's statement of facts does not agree with those ascertained by the key district specialist, the applicant may be requested to submit a supplemental statement modifying its factual contentions or a statement of its understanding as to the specific points in issue, before the file is forwarded to the National Office. See IRM 4(11)82.4, 83.2.

75. E.g., Lehrfeld and Webster, op. cit. page 30 above, at 607, estimated 50 percent. The Service believes the percentage of reversals is much lower now.

76. District conferees are instructed to encourage a district conference, although waived by the applicant, whenever the confree believes the issue can be resolved at the district level. IRM 4(11)82.4.

77. IRM 4(11)31.

78. Service procedures require a certified copy only of the organization's articles of incorporation or other basic governing instrument; bylaws need not be certified unless they constitute the governing instrument, as for some unincorporated associations. Rev. Proc. 68-14, 1968-1 Cum. Bull. 768; IRM 4(11)32. Apart from whether some district officials demand more paperwork than Service procedures require, it is not clear why certification should be necessary even for the governing instrument, since Code § 7207 makes it a crime to willfully and knowingly deliver to the Service a document that is false as to any material matter (whether the document is certified or not).

79. IRM (11)671.

80. See note 29, Supra.

81. Nor does the Technical staff control the type, or uses to be made, of data collected in the Exempt Organization Master File, which is maintained by the National Office's Audit Division, or the manner in which audits of exempt organizations are conducted.

82. First priority goes to inquiries from the congressional committees or staffs concerned with tax matters or inquiries from the Treasury Department or White House; second priority goes to other congressional inquiries; third priority is technical advice requests from District Directors. Rulings requests and exemption applications together have fourth priority and are handled in chronological order, except for cases specially expedited because of the needs of the applicant organization or interests of the community in which the organization is located or because of substantial congressional or governmental agency interest in the matter. Last priority is given to inquiries from individuals, complaints, etc. See generally, Lehrfeld and Webster, op. cit., note 68, supra., at 599-600.

83. The Conference and Review Staff may, upon its initial review of a technical advice case forwarded from a Rulings group, disagree with a proposed affirmation of a denial letter and recommend a favorable determination without a conference being necessary; if the Rulings Section cannot agree, the Branch Chief resolves the matter.

84. See IRM (11)172(1)(c).

85. It is difficult to determine how much time commissioners devote to exempt organization matters, and it undoubtedly varies. Commissioner Thrower (1969-71) is estimated to have given as much as 30% of his time to such matters. Most Commissioners in recent years have apparently devoted a substantial portion of their time to exempt organization questions, but rarely with respect to individual decisions. Theoretically, the Commissioner is not bound by the Chief Counsel's advice, but if an issue of "Treasury policy" is presented on which the Commissioner disagrees with the Chief Counsel's advice the matter is to be submitted to the Secretary or Deputy Secretary of the Treasury for resolution. The last such occasion recalled by one senior Service official involving an exemption ruling was 20 years ago, when the support of the Treasury Department was invoked by the Chief Counsel in two cases.

86. Lehrfeld and Webster, op. cit., note 68, supra., at 600.

87. Ibid., at 608.

88. Until a favorable exemption determination is issued, foundations considering grants cannot be certain that such grants will not be taxable expenditures under Code § 4945(d)(5); other prospective donors have no assurance that contributions will be deductible.

89. In *Center on Corporate Responsibility, Inc. v. Schultz*, 368 F. Supp. 863 (D.C.D.C. 1973), two years and eight months elapsed before a National Office ruling was issued; the ruling was issued two weeks after the applicant commenced suit. The case may fairly be regarded, however, as atypical. See note 197, infra.

90. The general criteria for referral are that, "Cases are referred to Interpretative Division in those instances in which the importance or complexity of the issue is such as to justify Chief Counsel consideration." IRM (11)172(1)(a)(1)(3).

91. The other is the Legislation and Regulations Division, which represents the Service in connection with tax legislation and prepares regulations. There is also an Associate Chief Counsel (Litigation) and an Operations and Planning Division of the Chief Counsel's office, with a Regional Counsel attached to each of the seven field regions.

92. Code § 7801(b)(2).

93. In the Legislation and Regulations Division, one of five Branches handles all exempt organization matters concerning legislative changes and preparation of regulations.

94. Until his recent retirement there was a Special Assistant to the Chief Counsel, assigned to the Office of the Associate Chief Counsel (Technical), who specialized in reviewing difficult 501(c)(3) determinations cases; since his retirement this function has been assumed personally by the Chief Counsel and the Associate Chief Counsel (Technical).

95. On March 13, 1975, the number of exempt organization matters pending in the Chief Counsel's Interpretative Division had been reduced to 78, of which 43 were proposed Revenue Rulings and 35 concerned particular organizations. The latter included 16 exemption qualifications under § 501(c)(3). This workload reduction may be due at least partly to temporarily decrease case referrals while the Service's Exempt Organizations officials were occupied with the reorganization recently in process under the new Assistant Commissioner (see Chapter III below).

96. IRM 4(11)52 provides: "Examining officers *may usually* discuss possible revocation or change in exempt status with officials of an organization before submitting recommendations. Generally, such discussions are essential for examining officers to obtain sufficient facts to make

their recommendations. However, if an examining officer believes that an organization is subversive, he should not discuss this with the organization's representative, but should prepare a detailed report setting forth all pertinent information, including the reasons for his views, and forward it to the National Office under the technical advice procedures . . ." (emphasis added) The reference to "subversiveness" is apparently an obsolete reference to Code § 508(g) disqualifying organizations designated by final orders of the Subversive Activities Control Board, which is no longer in existence; see also page 2615 below.

97. Rev. Proc. 72-4, 1972-1 Cum. Bull. 706. An exception to this procedure may be invoked "where delay would be prejudicial to the interests of the Internal Revenue Service (such as in cases involving fraud, jeopardy, the imminence of the expiration of the statute of limitations, or where immediate action is necessary to protect the interests of the Government)." Section 11.07, Rev. Proc. 72-4, 1972-1 Cum. Bull. 706. In such cases the District Director may issue a revocation notice prior to affording administrative appeal rights to the organization. In any other case warranting immediate action "to protect the interests of the Government," such as "in flagrant abuse cases when the organization is performing substantial acts clearly inconsistent with the exemption provisions of the Code and the Government's interest would be prejudiced by the time lapse which would be involved if normal appeal procedures were followed," the District Director must first obtain National Office approval before issuing a revocation notice prior to affording the organization appeal rights. IRM 4(11)91. In addition to such cases, a district-level conference is not afforded in any case involving "failure or refusal to comply with the tax laws because of moral, religious, political, constitutional, conscientious, or similar grounds." IRM 4(11)82.2. As in the case of adverse initial determinations, the absolute right to National Office review of revocations is currently being modified, see pages 2623, 2626 below.

98. Since retroactive revocation can result in assessment of past due taxes for all years remaining open under the statute of limitations, the courts require that exercise of this discretionary authority to take retroactive action not be abused. *Automobile Club of Michigan v. Commissioner*, 353 U.S. 180, 1 L.Ed. 2d 746, 77 S.Ct. 707 (1957); *Lesavoy Foundation v. Commissioner*, 238 F.2d 589 (3d Cir. 1956).

99. Sec. 11.01, Rev. Proc. 72-4, 1972-1 Cum. Bull. 706, 708. The reference to a "prohibited transaction" apparently is to Code Section 503, which provides for loss of exemption if certain prohibited self-dealing transactions are engaged in by otherwise exempt employee benefit plans; prior to the Tax Reform Act of 1969, but not since then, Section 503 applied also to some 501(c)(3) organizations. See pages 2659-60 below.

100. IRM (11)671.2(10)(4), .2(11)0. IRS Form 990, filed annually by all exempt organizations, calls for "a detailed description" of "any activities which have not previously been reported to" the Service and for a copy of "any changes" in the organization's "governing instrument, articles of incorporation, or bylaws, or other instruments of similar import."

101. IRM (11)671.2(10)4.

102. Sec. 11.01, Rev. Proc. 72-4, 1972-1 Cum. Bull. 706.

103. IRM (11)671.2(11)2.

104. See Sec. 13.05, Rev. Proc. 72-3, 1972-1 Cum. Bull. 698.

105. See Sec. 6, Rev. Proc. 72-2, 1972-1, Cum. Bull. 695; Lehrfeld & Webster, op. cit., note 68, supra., at 604.

106. Rev. Proc. 72-39, 1972-2 Cum. Bull. 818. However, deductibility may be denied where the contributor was aware that revocation was imminent or was "in part responsible for, or was aware of, the activities or deficiencies on the part of the organization that gave rise to the loss

of qualification," id. at sec. 3.01. The Service is apparently applying this criterion also for imposition of § 4945 penalty taxes upon private foundations for "taxable expenditures" in making grants to organizations with awareness that revocation of the grantee's exempt status was imminent.

107. Rev. Proc. 72-39, 1972-2 Cum. Bull. 818. See also IRM 4(11)92.

108. See Rev. Rul. 71-447, 1971-2 Cum. Bull. 230. The first instance of such advance suspension occurred before the Service developed any procedural rules on the subject, in connection with the 1966 revocation of the Sierra Club's 501(c)(3) status. See Grant, *The Sierra Club: The Procedural Aspects of the Revocation of Its Tax Exemption*, 15 UCLA L. Rev. 200 (1967).

109. The Tax Reform Act of 1969 made churches, previously exempt from these provisions, subject to the tax on unrelated business income effective in 1976.

110. Code § 513(a). At the same time, feeder organizations were denied exemption by section 502 only if the organization's "primary purpose" is carrying on a trade or business for profit.

111. S. Rep. No. 2375, 81st Cong., 2d Sess. at 29, 1950-2 Cum. Bull, 483, 504-505.

112. Now Treas. Reg. § 1.501(c)(3)-1(e)(1).

113. Treas. Reg. § 1.501(c)(3)-1(b)(1)(iii).

114. Treas. Reg. § 1.501(c)(3)-1(c)(1). These regulations can be read as being internally inconsistent, in that Reg. § 1.501(c)(3)-1(b)(1)(iii) applies the "organizational" tests and provides for no more than an "insubstantial" amount of unrelated business activity, while Reg. § 1.501(c)(3)-1(c) applies the "operational" test and embodies both a primary activity as well as an insubstantial activity test; Reg. § 501(c)(3)-1(e) retains the "primary purpose" test put into the Regulations after the Revenue Act of 1950.

115. IRM (11)671.741.1.

116. In the Service's view, the principal authority, now more than 40 years old, remains *Slee v. Commissioner*, 42 F.2d 184 (2d Cir. 1930), which held that lobbying for repeal of statutes dealing with prevention of conception was not "mediate to the primary purpose" or "ancillary to the end in chief" of the American Birth Control League.

117. See Rogovin, *Tax Exemption: Current Thinking Within the Service*, N.Y.U. 22d Ann. Inst. on Fed. Tax. (1964) 945, 959-960.

118. While the report for FY 1973 gives the figure 22,028 at page 18, the table at page 138 of that report shows 23,640 exempt organization returns examined. The annual report figures for exempt organization returns examined do not coincide with those shown at page 2610 below for audits completed, apparently because the annual report figures are for returns (years) rather than cases (entities). As applied to the 8,518 exempt organizations whose audits were completed in FY 1969 and the 18,980 completed in FY 1973, the annual report data on revocations recommended would indicate such recommendations in 1.96% of the audit cases completed in the former year and 1.33% in the latter year.

119. See the analysis at page 2612 below, indicating that final revocation results from less than 1% of 501(c)(3) organization audits but from more than 6% of audits of other types of exempt organizations.

120. See Rev. Proc. 72-3, 1972-1 Cum. Bull. 698.

121. Commissioner Alexander announced on July 31, 1974, that as soon as an appropriate procedure can be established the Service will release to the public all private ruling letters issued in the future (except those required by law) together with the supporting information supplied by the requesting taxpayers. Public comments on this proposed change of policy were solicited by News Release IR-1409, August 9, 1974. The Service has now formally proposed such a procedure for rulings and determination letters on most subjects, but not on exemption applications, by a Notice of Proposed Rulemaking, 39 Fed. Reg. 43087, December 10, 1974; the extent to which these procedures should apply to exemption applications is still under consideration. These procedures would require requests for rulings or determination letters to include a blanket waiver of confidentiality (except as to trade secrets or national defense or foreign policy secrets) and permit public inspection in the reading room of the Service's National Office beginning 30 days after the ruling or determination letter is issued, but would not permit a taxpayer to "rely upon, use, or cite as precedent any ruling issued to another taxpayer."

122. Testimony of Commissioner Alexander, *Hearings Before the Subcommittee on Foundations, U.S. Senate Committee on Finance*, June 3, 1974, p. 117.

123. See Testimony of Lawrence B. Gibbs, Assistant Commissioner (Technical), in *Hearings*, ibid, at 167. As of December 31, 1974, about 65 such rulings requests had been pending for longer than six months (page 2597 above).

124. See *Hearings*, ibid. at 171-177; "Public Supervision of Philanthropy and Charity, Can It Be Improved?," *Non-Profit Report*, December 1973, pp. 20-21.

125. The Service has recently indicated its readiness to issue advance rulings on whether proposed investments would jeopardize a foundation's exempt purposes, on an investment by investment basis. Rev. Rul. 74-316, IRB 1974-26, p. 17.

126. The Service's FY 1974 budget for its exempt-organization program is $21,138,000, of which $15,198,000 is allocated to audit functions. Testimony of Commissioner Alexander, *Hearing Before U.S. Senate Finance Committee, Subcommittee on Foundations*, June 3, 1974, p. 113.

127. Data is on completed audits as supplied by the Service. For FY 1974, 63.9% of the Service's total exempt organization examination expenditures were budgeted for private foundation audits. Ibid. at 114.

128. These figures, from the Service's Exempt Organizations Master File as of FY 1973, do not include about 6,400 Non-exempt Charitable Trusts (NECTs) which are treated as private foundations (NECTs increased to 7,700 as of March 31, 1974), nor do they include among 501(c)(3) organizations the numerous subordinate units covered by group rulings issued to central organizations; the Service's 643,586 figure for all exempt organizations, however, does include subordinate units of parent organizations other than religious organizations. As of June [illegible], 1974, there were 10,852 organizations whose foundation status had not yet been determined. See Appendix.

129. See *Giving USA, 1974* (American Association of Fund-Raising Counsel, Inc.), p. 6.

130. IRM 4(11)13. A list of exempt organizations on the NOCC list as of April 13, 1973, appears in *Hearings Before the Subcommittee on Domestic Finance of the Committee on Banking and Currency, U.S. House of Representatives*, on Tax Exempt Foundations and Charitable Trusts, April 5 and 6, 1973, pp. 227-245.

131. IRM 4(11)74.

132. Ibid. Until recently, National Office pre-closing review was also required for most private foundation audits involving "correction" of chapter 42 violations. Issuance of final Treasury Regulations on the subject is now believed by the Service to provide sufficient guidance for the field to handle most issues. IRM 4(11)55 as updated August 29, 1974.

133. IRM 4(11)95.

134. Section 7605(c) also requires that an officer of at least Regional Commissioner level believes the church "may be engaged" in such unrelated trade or business, and specifies that the religious activities not be audited except to determine whether the organization is a church (or convention or association of churches); a church's books may be audited only to the extent necessary to determine any tax that may be due. This provision was enacted in 1969 when churches were first made subject (starting in 1976) to the tax on unrelated business income. See also page 2655 below.

135. IRM 4(11)57.

136. IRM 4(11)94. The Service advises that this instruction is not intended to be limited to misleading statements concerning deductibility and that very few such press releases have been issued.

137. IRM 4(11)42.

138. Complaints are a separate source for planning audit coverage. See IRM 4(11)43.

139. IRM 4(11)45, as revised August 29, 1974.

140. IRM 4(11)46; Exempt Organization Master File Handbook, IRM 4(11)20.622.

141. *Tax Audit Guidelines – Exempt Organizations*, IRM 4(12)40, December 10, 1965.

142. *Audit Technique Guidelines, Religious, Charitable, Scientific, Literary and Educational Organizations – IRC 501(c)(3)*, Lesson 700-9, IRS Exempt Organization Training Program (Examinations) Document 3152-01 (January 1973).

143. Now section 501(f), which refers for definition of such organizations to the no-longer-existing Subversive Activities Control Board.

144. The Tax Reform Act of 1969 has since made section 503 inapplicable to 501(c)(3) organizations.

145. Since repealed by the Tax Reform Act of 1969.

146. IRM 4(11)52.

147. See also pages 2609-10 below.

148. IRM 4(11)G-29, sec. 3.03, May 15, 1972, now IRM 4(11)55.1(3).

149. IRM 4(11)54.3.

150. IRM 4(11)73. The size of the sampling in "all other" cases ranges from 14 to 33%, depending on the key district.

151. IRM 4(11)82.4.

152. IRM 4(11)55.

153. See Rev. Proc. 72-2, 1972-1 Cum. Bull. 695. If the examiner or reviewer rejects the taxpayer's request that technical advice be obtained, the taxpayer may appeal to the Chief of the district Audit Division and to the National Office Audit Division, whose decision on referral is final.

154. See IRM 4(11)76, 4(11)85.1. The Service advises that its unpublished Audit Manual, IRM 4422, provides only for cautioning that an *increase* of such activities may jeopardize exempt status, and that the failure of the manual's published provisions to delete instructions for cautionary advice on the mere continuance of existing activities is inadvertent. Nevertheless, "No Change Advisory Letters" have been sent to exempt organizations stating, "Please be advised that *continuation* or enlargement of the above mentioned activities may . . . adversely affect your exempt status in future years" [emphasis added].

155. See page 2594 above.

156. It is also forbidden by the Civil Service Commission for solicitations of federal employees. See pages 2633-34 below.

157. *Report and Recommendations* to the Commission on Private Philanthropy and Public Needs of the study on *Private Philanthropic Foundations*, prepared by the Council on Foundations.

158. Testimony of Commissioner Alexander, *Hearings Before the Subcommittee on Foundations, U.S. Senate Finance Committee*, June 3, 1974, p. 114.

159. IRM Manual Supplement 48G-222, September 18, 1974, Sec. 1. The field examination portion of the TCMP audit cycle is to be completed by December 31, 1976, for exempt organizations having assets or income of $1 million or more, and by February 1, 1976, for all others.

160. See the directive quoted at pages 2607-08 above.

161. News Release IR-1284, Remarks of Commissioner Johnnie M. Walters, prepared for delivery before Tax Exempt Organizations Institute, San Diego, California, January 12, 1973.

162. Brief for Amici Curiae in *Commissioner v. Americans United, Inc.*, 416 U.S. 752 (1974), p.26. See also *Speiser v. Randall*, 357 U.S. 513, 518 (1957): "It cannot be gainsaid that a discriminatory denial of a tax exemption for engaging in speech is a limitation on free speech."

163. Even during this period, the integrity of the Service in general was high. The Advisory Group to the Joint Committee on Internal Revenue Taxation reported, "We believe that the standards of integrity maintained by the Bureau [as it was then denominated] . . . are of a very high order. This is truly remarkable in view of the size and decentralized character of this organization and the inherent nature of tax determination which continuously provides opportunities for lesser standards. Honesty is not the only course open to thousands of Bureau employees, yet few choose to follow any other . . . Considering the levels of compensations, the handicaps under which many employees work, and the all too long and obvious neglect of the role of the Bureau in the country's welfare, only an unusual devotion and belief in the revenue service by the persons in it has kept the organization intact and operating." See Bierman, *Introduction to the Problems Facing Bureau of Internal Revenue Administration Today*, 7 N.Y.[illegible]t. Fed. Taxation 271, 281 (1949).

164. Steps taken under the Commissioner appointed in 1951 included background investigations, including tax audits for at least the previous three years, of every Internal Revenue employee throughout the country and summary dismissals with recommendations to the Justice Department for criminal prosecution. See *Statement of Commissioner John B. Dunlap*, 92 J. of Accountancy 700 (December 1951).

165. The Service's Chief Counsel is not in the career service, but he is organizationally an Assistant General Counsel of the Treasury Department rather than an employee of the Service.

166. Testimony of Commissioner Alexander, *Hearings Before the Subcommittee on Administrative Practice and Procedure, Committee on the Judiciary, U.S. Senate*, July 31, 1974 (prepared text p. 11).

167. Rev. Proc. 64-22, 1964-1 Cum. Bull. 689.

168. Code § 501(c)(3). The same standards govern the deductibility of contributions made to such organizations: see § 170(c)(2).

169. See the study by John B. Huffaker, "Legislative Activities of Charitable Organizations Other than Private Foundations with Addendum on Legislative Activities of Private Foundations." See also Troyer, *Charities, Law-Making, and the Constitution: The Validity of the Restrictions on Influencing Legislation*, 31 N.Y.U. Inst. on Fed. Tax. 1415 (1973).

170. Code § 4945 makes any amount paid or incurred by a private foundation for such activity a "taxable expenditure" subject to penalty taxes.

171. The Service instructs its own personnel that "attempting to influence legislation" includes "... all appeals to the general public, not merely those that contain a request to contact a legislator or take other specific action ... If the underlying purpose is the advocacy of particular legislation, then there has been an attempt to influence legislation within the meaning of the Code ... In determining substantiality, it is sometimes difficult to determine what supporting activities should be included within the proscribed attempts to influence legislation ... Attempting to influence does not necessarily begin at the moment the organization first addresses itself to the public or to the legislature ... There is no simple rule as to what amount of activities is substantial. The one case on this subject is of very limited help." IRS Exempt Organizations Handbook, IRM (11)671.762, 764 (April 19, 1972).

172. In 1963 the Service revoked the exempt status of the Fellowship of Reconciliation on the ground that its goals – the achievement of peace and international reconciliation through love – were political in character and attainable only through legislation. As a result, Senator Nelson wrote the Commissioner asking, "Exactly how did the Internal Revenue Service determine that world peace could be secured only through legislation and could you give me an example of the legislation needed to bring this about? See Note, *The Revenue Code and a Charity's Politics*, 73 Yale L.J. 661 (1964). The exempt status was later restored.

173. See Clark, *The Limitation on Political Activities: A Discordant Note in the Law of Charities*, 46 Va. L. Rev. 439 (1960); Note, *Regulating the Political Activity of Foundations*, 83 Harv. L. Rev. 1843 (1970). But see Lehrfeld, *The Taxation of Ideology*, XIX Cath. U.L. Rev. 50 (1969).

174. See Lehrfeld, ibid., pp. 67, 72-73.

175. Even after the 1950 enactment of the disqualification for "Communist-controlled" organizations – now referenced by §501(f) – the Service never relied upon that provision in denying or revoking an exemption; no rulings or regulations on the application of that provision have ever been issued. The provision is now a dead letter, since it refers to final orders of the Subversive Activities Control Board for designation of the disqualified organizations; that board no longer exists.

176. The Assistant Commissioner testified before the Reece Committee in 1954:

> The term "un-American" does not appear as such, in the tax laws or regulations. I have no hesitancy in stating, however, that it is the firm policy of the Revenue Service to deny exemption to any organization which evidence demonstrates is subversive.

> The determination of the Revenue Service denying exemption must, however, be based on lack of qualification under the terms of the tax law, namely failure to qualify as an organization organized and operated exclusively for educational purposes. It is our belief that an organization which is truly subversive cannot be considered as exclusively educational.
>
> There are no organizations [on the Attorney General's List] which are also on our list of exempt organizations.

Hearings Before the House Special Committee to Investigate Tax Exempt Foundations and Comparable Organizations, 83d Cong., 2d Sess. 434 (1954), reprinted in 32 Taxes 533 (1954).

177. *Institute of Pacific Relations v. United States*, 1960-1 USTC ¶9404, 5 Ann. Fed. Tax F.2d 1333 (S.D.N.Y. 1960). The Institute obtained judicial review by suing for refund of F.I.C.A. taxes. Not until a year after the court's decision (six years after the revocation) did the Service restore exempt status; by then the institute's contributions had so diminished that shortly thereafter it went out of existence for lack of funds.

178. Clark,*The Limitation on Political Activities: A Discordant Note in the Law of Charities*, 46 Va. L. Rev. 439, 460 (1960).

179. In 1966, four organizations interested in national beautification or in supporting the Vietnam War effort apparently received favorable exemption rulings within only two to 10 days after application. A professional newsletter thereupon advised its subscribers: "Some exempt organization cases which are of a sensitive nature or [in] which a person of some importance is interested, reuuire very little time for a ruling to issue." *Non-Profit Organization Tax Letter*, May 12, 1966.

180. See Kuttner, "The Taxing Trials of I.R.S.," *The New York Times Magazine*, January 6, 1974.

181. *Christian Echoes National Ministry, Inc. v. United States*, 470 F. 2d 849 (1972), cert. den., 414 U.S. 864 (1973)

182. Ibid., 28 AFTR 2d 71-5934 (D. Okla. 1971).

183. 470 F. 2d at 857-858.

184. *Investigation Into Certain Charges of the Use of Internal Revenue Service for Political Purposes, Prepared for the Joint Committee on Internal Revenue Taxation by its Staff*, 93d Cong. 1st Sess. December 20, 1973 (Committee Print).

185. Ibid., p. 15.

186. A further report by the Joint Committee staff is expected.

187. Memorandum for H.R. Haldeman from Tom Charles Huston on "IRS & Ideological Organizations," September 21, 1970, in *Statement of Information, Book VIII Internal Revenue Service, Hearings Before the Committee on the Judiciary, House of Representatives, 93d Cong., 1st Sess., Pursuant to H. Res. 803*, May-June 1974, [hereinafter cited as "Statement of Information"], p. 44.

188. Ibid., pp. 50-51. A less sanguine description of the Special Service Staff's impact appears in Nielsen, *The Big Foundations* (Columbia University Press, 1972), pp. 375-376: "During 1970, the initial efforts of the Internal Revenue Service to carry out its new policing and censorship assignments stirred fears of a new kind of administrative McCarthyism emerging in the guise of enforcement of the tax law. The IRS raised the specter of bankruptcy for a number of small

intellectual and schorlarly journals by its attempts to tax their advertising income. It appeared to scrutinize with extraordinary severity the editorial content of the undergraduate student newspaper of Columbia University, which had been outspokenly critical of the Nixon administration's policies, to see if its tax exemption should be revoked. It reportedly threatened American universities with loss of their tax exemption if they should permit their students a holiday to work as volunteers in the 1970 election campaign. Similarly, it threatened to remove the tax exemption of a number of public interest nonprofit law firms, whose creation had been inspired by the consumer crusader Ralph Nader, if they pressed litigation against corporate polluters of the environment. It formulated a draft regulation to remove the tax exemption of 'activist' organizations, specifically black civil rights and antiwar groups. Concurrently, Internal Revenue agents 'auditing' the records of foundation in accordance with the terms of the 1969 tax act began to insist upon examining not only financial data but also confidential background memoranda relating to applicant organizations and grantees. In some cases, quantities of documents containing information about individual student organizers, academic specialists, and labor, black, and Mexican-American leaders who had been involved in foundation projects were Xeroxed and shipped to government files in Washington. Even religious bodies reported an increasing number of disquieting encounters with IRS. In December 1971 an organization of thirty Episcopal clergymen and Wall Street lawyers, the prestigious Guild of St. Ives, publicly accused the federal tax officials of overstepping their authority in restricting political activity by churches. They thus brought to the surface a simmering felling among liberal churchmen throughout the nation that the Nixon administration has adopted a policy of 'intimidation' by use of the threat of loss of tax exemption. (*The New York Times*, December 12, 1971)."

189. Briefing memorandum prepared for H.R. Haldeman by John W. Dean III and John Caulfied, prior to meeting of November 7, 1971, in *Statement of Information* at 196-198.

190. Ibid., pp. 57-58, 223.

191. *Political Intelligence in the Internal Revenue Service: The Special Service Staff*, A Documentary Analysis Prepared by the Staff of the Subcommittee on Constitutional Rights of the Committee on the Judiciary, U.S. Senate, 93d Cong., 2d Sess., December 1974 (Committee Print).

192. Ibid., p. 19. An analysis of one exempt organization, prepared in 1971 by the Internal Security Division of the Justice Department and included in the SSS files, concluded that although a legitimate philanthropic enterprise, the organization had apparently served "as a conduit for funds to support black militants and organizations which are known to consistently promote radical revoluntionary activities," and recommended additional investigation. Ibid., pp. 262-265.

193. Ibid., p. 28.

194. Ibid., p. 14.

195. Ibid., p. 28.

196. Ibid., pp. 20-21.

197. Ibid., pp. 25-26, 175. Not mentioned in the Constitutional Rights Subcommittee's staff report but pertinent in this context is *Center on Corporate Responsibility, Inc.* v. *Schultz*, 368 F. Supp. 863. (D.D.C. 1973), in which the application for exemption, filed in September 1970, was not ruled upon until May 1973, when exemption was denied two weeks after the Center had instituted suit. The court found that the "inference" of political intervention had been "unmistakenly raised" by available evidence, and expressed concern with "the creation of a political atmosphere generated by the White House in the Internal Revenue Service which may have affected the objectivity of those participating in the ruling in the Plaintiff's case." The

issue of political influence was never resolved on the merits. The government, without having sought a protective order, failed to comply with discovery orders to produce documents and tapes. As a sanction for noncompliance with those orders, the court held that the Center's allegation of selective treatment for political, ideological, and other improper reasons would be "deemed established."

198. News Release IR-1395, Remarks of Commissioner Alexander Before the American Newspaper Publishers Association, New York, N.Y., April 23, 1974.

199. Practicing attorneys seem generally to give the Service high marks for non-partisanship, but at least one prominent attorney experienced in cases involving New Left organizations believes that the Service has harassed such organizations with repeated audits, revocations proposed on specious grounds, and arbitrary delays in exemption rulings. In the nonexempt area, recent investigations have disclosed a disquieting degree of cooperation by an Assistant Commissioner in White House efforts to stimulate audits of individuals, dubious processing of the President's tax returns, and questionable handling of an advance ruling issued to the International Telephone & Telegraph Corp. In the latter case, however, the Service itself moved subsequently to reverse the ruling.

200. Kuttner, "The Taxing Trials of I.R.S.," *The New York Times Magazine*, January 6, 1974.

201. Testimony of Commissioner Alexander, *Hearings Before the Subcommittee on Administrative Practice and Procedure, Committee on the Judiciary, U.S. Senate*, July 31, 1974 (prepared text p. 11).

202. Joseph C. Goulden, "The Hostile Bureaucracy," *Washingtonian Magazine*, May 1974.

203. The Procedures Section of the National Office Audit Division's Exempt Organization Examination Branch, which handles correspondence with persons outside the Service on matters concerning exempt organization audits, processed 1,356 letters during 1973, of which 639 were taxpayer inquiries, 663 were congressional inquiries, and 54 were in miscellaneous categories. The Exempt Organizations Branch of the National Office's Technical Staff devoted only 2% of its time to congressional and other outside correspondence in FY 1973.

204. Treas. Reg. §301.6104-3(c); IRM 4(11) (10)3.3.

205. IRM 4(11) (10)3.3.

206. E.g., Testimony of Julius Greenfield, Assistant Attorney General, State of New York, and Testimony of J. John Stevenson and Robert J. O'Rourke, Assistant Attorney General and Deputy Attorney General, State of Illinois, in *Hearings Before the Subcommittee on Domestic Finance of the Committee on Banking and Currency, U.S. House of Representatives*, on Tax Exempt Foundations and Charitable Trusts: Their Compliance With the Provisions of the Tax Reform Act of 1969, April 5 and 6, 1973, pp. 183, 210-212.

207. Testimony of Lee H. Henkel, Jr., Chief Counsel of the Internal Revenue Service, in ibid., at 219.

208. IRM Manual Supplement 4(11)G-37, June 27, 1973.

209. Remarks of Commissioner Alexander before the National Association of Attorneys General, Atlanta, Georgia, January 17, 1974, as summarized in *Regulation of Charitable Trusts and Solicitations: Summary of the Special Meeting of the Subcommittee on Charitable Trusts and Solicitations*, National Association of Attorneys General Committee on the Office of Attorney General, April 1974, p. 60. That summary gives the figure 7,800 for 1973 alone, but the Service's Audit Division advises that the figure is probably cumulative.

210. Code Section 7802(b), as amended by section 1051(a) of the Employee Retirement Income Security Act of 1974, P.L. 93-406, 88 Stat. 951. The new Assistant Commissioner is to be a member of the career, classified at GS-18. The Service is authorized an additional 20 positions at the level of GS-16 and 17.

211. Section 1052 of the Employee Retirement Income Security Act of 1974, P.L. 93-406, 88 Stat. 952, 31 U.S.C. §1037.

212. Private foundations generally have objected to the tax on two grounds: *First*, the revenues generated have greatly exceeded chapter 42 administrative and auditing costs; *Second*, although the tax is rationalized by reference to chapter 42 and auditing, it is in fact paid into general Treasury funds and thus seems to be a precedent for taxing charity. A specific fee earmarked for chapter 42 and auditing, and related to the cost of such activities, would have avoided these problems.

213. In FY 1974, revenues from the §4940 tax decreased to $69.8 million from the FY 1973 level of $76.6 million. News Release IR-1435, December 9, 1974.

214. S. Rep. No. 93-383 (Committee on Finance), 93d Cong., 1st Sess., August 21, 1973, pp. 107-109; H. Rep. No. 93-807 (Committee on Ways and Means), 93d Cong., 2d Sess., February 21, 1974, pp. 103-105. [Emphasis added.]

215. IRM Manual Transmittal 1100-155, February 19, 1975.

216. News Release IR-1422, September 30, 1974.

217. See remarks on Alvin D. Lurie, Assistant Commissioner (EPEO), before the Tax Section, American Bar Association, San Diego, California, February 7, 1975, as reported in Prentice-Hall Federal Taxes Bulletin ¶60,185 (February 20, 1975). Assistant Regional Commissioners (EPEO) have been delegated authority to enter into closing agreements relating to tax liability of exempt organizations, 1975 Int. Rev. Bull. No. 9, p. 23, March 3, 1975.

218. Rev. Proc. 73-8, 1973-1 Cum. Bull. 754.

219. No change is currently expected in the criteria for initial referral of new applications for National Office rulings.

220. The risk of such inconsistency might be diminished somewhat if the Assistant Commissioner (EPEO), in adopting a procedure for making rulings and determinations available for public inspection, declines to follow the procedure recently proposed for other rulings areas of forbidding taxpayers to "rely upon, use, or cite as precedent any ruling issued to another taxpayer." See page 2603 above. We believe affected organizations should be permitted to rely upon other exemption rulings as persuasive, but not necessarily conclusive, precedents.

221. IRM 1113.81-83.

222. See pages 2621-22 above.

223. The Service's publications are likely to increase in the pension area. The Senate Finance Committee stated: "It is intended that the Internal Revenue Service obtain from all appropriate pension administration sources annual statistical data to indicate the operations of the private retirement system for the purpose of evaluations and public information." S. Rep. No. 93-383 (Committee on Finance), 93d Cong., 1st Sess., August 21, 1973, p. 34.

224. IRM 1114.9, as amended by Manual Transmittal MT 1100-155, February 19, 1975.

225. The Division structure is flexible depending upon the size of the operation, geographic dispersion of personnel, and additional program objectives. In some district offices the branch supervisory structure will be less elaborate or nonexistent. IRM 1118.8, as amended by MT 1100-155, February 19, 1975.

226. IRM 1118.82, as amended by MT 1100-155, February 19, 1975.

227. IRS Delegation Order 113 (Rev. 2), January 2, 1975.

228. There are about 570 pension trust specialists and about 380 exempt organization specialists in the Service's field organization. News Release IR-1422, September 30, 1974. Increased Service responsibilities under the Employee Retirement Income Security Act of 1974 may result in additional field personnel in the pension trust area, but some increase seems probable in the exempt organization area as well.

229. Executive Order No. 10927, March 18, 1961.

230. Manual on Fund-Raising Within the Federal Service, Office of the Chairman, U.S. Civil Service Commission, February 1973 [hereinafter cited as "CSC Manual"], secs. 6.4, 6.5.

231. "Evaluation of Fall 1973 Combined Federal Campaigns," memorandum of Irving Kator, Assistant to the Chairman, Civil Service Commission, July 24, 1974.

232. Executive Order No. 10728, September 6, 1957.

233. CSC Manual, sec. 5.21.

234. 39 Fed. 44674, December 26, 1974.

235. CSC Manual, secs. 3.1, 4.2. At locations where a national health agency, international service agency, or the Red Cross is already a participant through the local Community Chest or United Fund, it does not constitute a separate category. Local agencies not members of or recognized by the United Way may be approved for participation only at locations where there is no United Way federation (ibid., secs. 3.44, 3.552). At such locations, qualifying local participants must be "local health, welfare, or recreational service agencies, such as visiting nurse associations, homes and clinics for children and the aged, and neighborhood centers for youth recreation and guidance" (ibid., sec. 3.1a).

236. The Eligibility Committee consists of a chairman and four members selected by the CSC Chairman from the membership of the Policy Committee (comprised of fund-raising program coordinators from the federal agencies and representatives of the largest employee organizations in the federal service). CSC Manual, secs. 2.13, 2.14.

237. *United Black Fund, Inc.* v. *Hampton*, 352 F. Supp. 898 (D.C. D.C. 1972). The applicant group alleged, but offered no supporting evidence, that the local united fund engaged in racially discriminatory practices. The court held that substantial evidence supported the CSC Chairman's contrary finding following his investigation of the allegations, and that the Chairman satisfied due process requirements by affording the applicant an opportunity to present its allegations at a meeting with him.

238. CSC Manual, sec. 7, requires participating local agencies to provide assurance of racial nondiscrimination. The pending amendments expand this requirement to include non-discrimination on the basis of religion, ethnic origin or sex, and eliminate the exemption which local chapters of the American Red Cross have heretofore been granted from the requirement of filing nondiscrimination assurances. 39 Fed. Reg. 44674, December 26, 1974.

239. The Red Cross is treated in a category by itself. Where there is no local United Way federation, an exception permits certain other local agencies to qualify. See note 235, supra. 184 above.

240. CSC Manual, sec. 5.24, as proposed to be amended, 39 Fed. Reg. 44674, December 26, 1974. The amendments codify existing practice.

241. 39 Fed. Reg. 44674, December 26, 1974.

242. These standards, currently being revised, were published in 1964 by the National Health Council and the National Social Welfare Assembly (presently the National Assembly for Social Policy and Development) and their members and affiliates. See pages 2656-57 below.

243. CSC Manual, secs. 5.41, 5.46.

244. CSC Manual, sec. 3.551.

245. CSC Manual, secs. 5.3, 5.4, as proposed to be amended, 39 Fed. Reg. 44674, December 26, 1974. The pending amendments codify prior practice concerning the requirements discussed above.

246. In addition, by treating the United Way of America as a single national agency, including its local affiliates and their member agencies, it permits participation by many charitable groups that could not qualify independently as "national" voluntary agencies under Executive Order No. 10927.

247. In addition to the Eligibility Committee, noted at page 2632 above, the Chairman has a four-member advisory council "to assist and advise him in the development of policies, procedures, and eligibility requirements." However, the Chairman has specified that the members of this council consist of the president of the American Red Cross, the president of the United Way of America, and the presidents of a participating national health agency and a participating international agency. CSC Manual, sec. 2.12. In considering the questions discussed above (and perhaps others), broader membership in the advisory council seems desirable.

248. H. Rep. No. 93-1084, June 6, 1974, 93d Cong., 2d Sess., 1974 U.S. Code Cong. & Admin. News 1926, 1928.

249. Former 39 U.S.C. §§ 4351-4370 (second-class mail); 39 U.S.C. §§ 4451-4452 (third-class mail); 39 U.S.C. §§ 4551-4559 (fourth-class mail). The reduced rates for these classes were deemed to constitute "public services" on which the operating losses were met by direct appropriations rather than by adjusting postal rates and fees, former 39 U.S.C. §§ 2302-2303.

250. Pub. L. 91-375, August 12, 1970, 84 Stat. 774; see note preceding 39 U.S.C.A. §101 (1975).

251. In determining the full cost level to which the reduced rates must be increased over the phase-in period, the Postal Service is to include an assignable share of its institutional costs for mailings of reduced rate commercial mailers but *not* for those of nonprofit mailers, 39 U.S.C. § 3626; cf. *Ass'n of Amer. Publishers, Inc. v. Governors of U.S. Postal Service*, 485 F.2d 768, 777-778 (D.C. Cir. 1973). "Revenue foregone" by the difference between such full cost and the reduced rate is authorized to be appropriated by Congress each year until the phasing periods are completed, 39 U.S.C. § 2401(c). If Congress fails to appropriate such funds, the postal rates for the affected class may be adjusted to provide sufficient revenue to make up the deficiency, 39 U.S.C. § 3627.

252. 39 U.S.C. § 3626, as amended by Pub. L. 93-328, §1, June 30, 1974, 88 Stat. 287. 39 U.S.C.A. § 3626 (Supp. 1975).

253. 39 C.F.R. §§ 132.1(b)(2), 132.2(c), based upon former 39 U.S.C. §§ 4355, 4358 (second class); 39 C.F.R. § 134.5, based upon former 39 U.S.C. §,4452(b) (third class); 39 C.F.R. § 135.2(a)(5), based upon former 39 U.S.C. § 4554(b) and (c) (fourth class).

254. War Revenue Act of 1917, Pub. L. No. 50, October 3, 1917, § 1103, 40 Stat. 328, 330, subsequently codified as 39 U.S.C. § 4359(e), which in 1963 became 39 U.S.C. § 4358(j)(2).

255. 38 Fed. Reg. 1566, January 15, 1973.

256. Compare 39 C.F.R. § 134.5 (1974) with Treas. Reg. § 1.501(c)(3)-1. The Postal Service's definition of a non-profit "religious" organization is one "whose primary purpose is one of the following: (i) To conduct religious worship – for example, churches, synagogues, temples, or mosques; (ii) To support the religious activities of nonprofit organizations whose primary purpose is to conduct religious worship; (iii) To perform instruction in, to disseminate information about, or otherwise to further the teaching of particular religious faiths or tenets."

257. 39 C.F.R. § 134.5(b)(4)(vi); Treas. Reg. § 1.501(c)(3)-1(d)(2). See note 48, supra.

258. Internal Revenue Code § 501(c)(4); see Treas. Reg. § 1.501(c)(4)-1(a)(2).

259. *Sierra Club v. U.S. Postal Service*, No. 74-1830, 9th Circuit Court of Appeals, now pending; *Nat'l Rifle Ass'n v. U.S. Postal Service*, Civil Action No. 75-0303, U.S. District Court for the District of Columbia, filed March 5, 1975. The issue has been raised more clearly in the latter case.

260. 39 C.F.R. §§ 132.3(f), 132.8.

261. 39 C.F.R. Part 954.

262. Compare *Goldberg* v. *Kelly*, 397 U.S. 254 (1970) (procedural due process entitles welfare recipients to evidentiary hearing and decision based on record before impartial decision maker who did not participate in determination under review, before welfare benefits may be terminated). The Administrative Procedure Act is inapplicable to the Postal Service, 39 U.S.C.A. § 410 (Supp. 1975).

263. The constitutionality of these Postal Service procedures is presently under review by the U.S. Court of Appeals for the Ninth Circuit in the *Sierra Club* case noted at page 2637 above and may also be reviewed in the *National Rifle Association* case there noted.

264. In the *National Rifle Association* case noted at page 2637 above, the organization alleges that revocation of its special second-class rates will cost it at least $300,000 per year and that revocation of its special third-class rates will cost it at least $600,000 per year.

265. Estimates provided by the Mail Classification Director. There are about 33,000 second-class permits outstanding, of which perhaps 10,000 are for the special nonprofit rates. Annually about 1,300 second-class permits, of both commercial and nonprofit mailers, are revoked or abandoned.

266. 39 C.F.R. § 134.5(d), (f). No permit is required for the fourth-class "library rate", ibid., § 135.2(a)(5).

267. Estimate provided by the Mail Classification Director. There are about 109,000 special nonprofit third-class permits outstanding.

268. The Foreign Assistance Act of 1961 declared the sense of Congress that nonprofit voluntary agencies "registered with and approved by" the advisory committee should be used

"to the maximum extent practicable" in furthering the purposes of the Act. 22 U.S.C. §2395(c). In the Foreign Assistance Act of 1973, Congress directed that U.S. bilateral support for development "should be carried out to the maximum extent possible through the private sector, including those institutions which already have ties in the developing areas, such as educational institutions, cooperatives, credit unions, and voluntary agencies." 22 U.S.C.A. §2151(b) (Supp. 1975).

269. 7 U.S.C. §1722 (P.L. 480 food); 22 U.S.C. §2176 (ocean freight reimbursement); 22 U.S.C. §§2357-2358 (excess government-owned property). The American Red Cross is separately eligible for the latter two subventions.

270. The advisory committee was originally "appointed by the Secretary of State and the Secretary of Agriculture jointly on May 14, 1946, at the request of the President, to succeed the President's War Relief Control Board" (which terminated on that date). Department of State Regulation 108.54, 12 Fed. Reg. 7353, November 11, 1947. The War Relief Control Board had been established by Executive Order in 1942 to guide private relief agencies in their government relationships and to license approved programs. Until enactment of the Foreign Assistance Act of 1961 and the Food for Peace Act of 1966, the advisory committee's authority to determine eligibility for subventions was administratively delegated by the Secretary of State and foreign aid administrators. Even at present, no statute or Executive Order establishes the advisory committee or prescribes its functioning. See generally the 1974 study prepared for AID by the Advisory Committee, *The Role of Voluntary Agencies in International Assistance: A Look to the Future*, April, 1974 [hereinafter cited as "1974 Advisory Committee Study"] pp. 21-22, 133-134.

271. See Hearings Before the Subcommittee on Children and Youth of the Senate Committee on Labor and Public Welfare, on *Children's Charities: Part 4, Voluntary Foreign Aid Agencies Serving Children and Youth*, 93d Cong., 2d Sess., October 10, 1974 [hereinafter cited as "Charities Hearings"] at 1,034. The total staff of the Office of Private and Voluntary Cooperation, until recently numbering 31, is to be reduced to 24 by June 30, 1975. Ibid., at 1,097.

272. 1974 Advisory Committee Study, pp. 141-142.

273. 22 C.F.R. §203.3 (1974).

274. Ibid. The advisory committee also requires applicants to file an audited financial statement for the prior year, certified by an independent CPA, and to show financial resources sufficient to perform the proposed service, including contributions adequate to provide assurance of continued support; registrants must also file an annual statement of income and expenditures.

275. See 1972 and 1973 reports of the advisory committee, "Voluntary Foreign Aid Programs", published by AID; see also 1974 Advisory Committee Study at 136.

276. See *Charities Hearings* at 1,036, 1,092-1,093.

277. See *Charities Hearings* at 1,036-1045, 1,092-1,098. The advisory committee's staff is to notify a registered agency of concern and seek corrective action if the agency's fund-raising costs each 20% of its contributed income; registered agencies whose fund-raising costs reach 30%, on the same formula, are to be brought to the advisory committee's attention without prior staff action. See 1974 Advisory Committee Study at 122-123. Nevertheless, among the 91 registered agencies listed in the advisory committee's 1973 report, 7 show "administration and promotion" costs exceeding 50% of total income; 1 exceeds 100% and 3 others exceed 90%, 70% and 60% respectively.

278. *Charities Hearings* at 1,044-1,046.

279. Ibid., at 1,097. See chapter VI [pages 2644-58] below for detailed discussion of pending proposals, and our recommendation, for such a regulatory system.

280. Section 5 of the proposed Truth in Contribution Act, S. 1153 and H.R. 4689, introduced on March 12, 1975; see page 2652 below.

281. By a report dated January 31, 1975, an advisory committee consultant retained to study the registration process recommended to AID and to the advisory committee that registration be abolished and that AID formally and publicly assume responsibility for selecting recipients of the subventions, thus relieving the advisory committee of operational functions so it can focus on policy questions and liaison functions and freeing AID of "a responsibility for the integrity of domestic fund raising which is not part of its mandate" and which is "beyond the Committee's ability to support." Bartlett Harvey, *Registration and Approval of Voluntary Foreign Aid Agencies by the Advisory Committee on Voluntary Foreign Aid of The Agency for International Development*, A Report to the Committee and the Agency, January 31, 1975, pp. 66-68. In response to that report, the advisory committee has recommended continuance of the status quo with augmented staff to administer the registration function more effectively; no decision has yet been made by AID.

282. See *Philanthropy in the 70s: An Anglo-American Discussion*, A Report on the Anglo-American Conference on the Role of Philanthropy in the 1970s (The Council on Foundations, Inc. 1973).

283. We rely particularly upon the discussion by Sheldon Cohen, Thomas A. Troyer, Marion R. Fremont-Smith, and John S. Nolan at a Smithsonian Institution Seminar on "Voluntarism and the Public Interest in American Society," published as articles entitled, "Public Supervision of Philanthropy and Charity, Can It Be Improved?," in *Non-Profit Report*, December 1973 and January 1974; the testimony of Alan Pifer, Marion R. Fremont-Smith, and Sheldon Cohen in *Hearings Before the Subcommittee on Foundations, Committee on Finance, U.S. Senate, October 1 and 2, 1973*, pp. 265-277; and a discussion paper entitled, "Possible Structure of Federal Agency for Charitable Organizations," by John S. Nolan and Thomas A. Troyer, September 15, 1972. See also the *Report and Recommendations* on *Private Philanthropic Foundations*, the Council on Foundations, op cit., at pp. VI-17 to VI-20.

284. Testimony of Sheldon Cohen in *Hearings*, op cit., note 283, supra, p. 274. Mr. Cohen was addressing the issue "if we were going to start over again, if there were no history of where exempt organizations had been administered, what would be the best system" but, as we understand it, proponents of the proposal believe that it should go forward now.

285. If a completely independent commission is not feasible, the proposal suggests as the next best alternative a separate organization within the Treasury Department but not within the Internal Revenue Service. Ibid., p. 275

286. In Great Britain, where these functions are lodged in separate agencies, charitable contributions are generally not deductible by donors. This difference affects incentives for tax abuse.

287. American Association of Fund-Raising Counsel, Inc., *Giving USA*, 1975, p. 6. Of the individual contributions, $19.80 billion were gifts, $2.07 billion were bequests.

288. The Postal Service relies primarily upon complaints from the public in initiating investigations leading to proceedings to deny mail delivery to persons engaged in a "scheme or device" for obtaining money through the mail "by means of false representations," 39 U.S.C. §§3005, 3007. The Consumer Protection Office (formerly the Fraud Branch) of the Postal Service advises that in the last three years not more than three or four such proceedings have been brought involving organizations claiming to be charities (one involved a lottery), apparently because complaining to the Postal Service does not often occur to the public.

289. National Information Bureau, 1973 Annual Report, p. 9. The NIB is a nonprofit corporation, organized in 1918 to establish philanthropic standards and provide information to contributors. The NIB presently provides reports to members on about 500 soliciting organizations.

290. *Hearings Before the Subcommittee on Children and Youth, U.S Senate Committee on Labor and Public Welfare*, on Children's Charities, 1974, Part 1, February 4, 5, 6, March 11 and 12, 1974 [hereinafter cited as "Charity Hearings"]; "Give to Charities, But Check Them Out First," Changing Times, *The Kiplinger Magazine*, December 1973, p. 21; "Charities: Which Ones Are Worth Giving To?", *Reader's Digest*, February 1974, p. 82; "How Your Charity Dollar Often Buys a Nickel's Worth of Good for the Cause," *Washington Star-News*, June 27, 1974, p. 1; "Mail Order Millions," *The Washington Post*, September 1, 1974, p. 1, September 2, 1974, p. 1, September 3, 1974, p. 1; "Appeals Sometimes Vary a Bit From the Facts," *Washington Star-News*, October 9, 1974, p. A-3; Harvey Katz, *Give! Who Gets Your Charity Dollar?* (Garden City, N.Y.: Anchor Press/Doubleday, 1974). And see note 277, supra.

291. See "Volunteer Organizations – Boiler Room Telephone Operations," in *In-Sight*, December 1972 – January 1973, a solicitations review newsletter published by the Council of Better Business Bureaus, Inc.

292. *Washington Star-News*, p. A-3, October 9, 1974. The executive director of the agency was quoted as saying, "when we get an ad that pulls, we continue to use it."

293. It is estimated that at least 100 charities conducting national direct mail solicitations enclose unsolicited items or merchandise. See "Charities: Don't Feel Guilty About Unwanted 'Gifts'," *The Christian Science Monitor*, February 20, 1974; "Unordered Merchandise," in *In-Sight*, April 1973, a solicitations review newsletter published by the Council of Better Business Bureaus, Inc.

294. Sec. 5.34, Manual on Fund-Raising Within the Federal Service, U.S. Civil Service Commission, February 1973. See page 2634 above.

295. The *Standards for Charitable Solicitation,* issued August 1974 by the Council of Better Business Bureaus provides, "Soliciting organizations shall not pay commissions, kick-backs, finders' fees, percentages, bonuses or over-rides for any fund-raising activity, including telephone, door-to-door, direct mail or other method." The *Fair Practice Code* of AAFRC provides, "Member firms do business only on the basis of a specified fee, determined prior to the beginning of the campaign. They will not serve clients on the unprofessional basis of a percentage or commission of the sums raised. They maintain this ethical standard also by not profiting, directly or indirectly, from disbursements for the accounts of clients." The National Information Bureau's *Basic Standards in Philanthropy* specify, "No payment of commissions for fund raising." Nevertheless, the Internal Revenue Service instructs its revenue agents that professional fund raisers "usually" get a percentage of the gross contributions received; see page 2609 above.

296. It seems equally clear that the federal government has the necessary constitutional power. Regulation could be assumed under the relatively untrammeled federal tax power, as has other regulation of 501(c)(3) organizations. More appropriate, regulation is authorized under the commerce clause, which encompasses nonbusiness and nonprofit activities, whether private or governmental in nature. See *Maryland* v. *Wirtz*, 269 F. Supp. 826 (D. Md. 1967) (three-judge court), aff'd 392 U.S. 183, 88 S. Ct. 2017, 20 L. Ed. 2d 1020 (1968); *Public Building Authority* v. *Goldberg*, 298 F. 2d 367 (5th Cir. 1962); *NLRB* v. *Central Dispensary and Emergency Hospital*, 145 F. 2d 852 (D.C. Circ. 1944). The federal postal power also provides a basis for regulating the use of the mails for solicitations, as in the case of the Interstate Land Sales Full Disclosure Act, 15 U.S.C.A. §7103.

297. Testimony of Philip J. Sgarlata, Director, New York State Charity Registration Bureau, in *Charity Hearings*, p. 194.

298. Only seven states have at least one attorney assigned full-time by the state attorney general's office to enforcement of charitable solicitation statutes. See the study prepared for the Commission on Private Philanthropy and Public Needs by the Ohio Attorney General, *"The Status of State Regulation of Charitable Trusts, Foundations and Solicitations,"* 1974.

299. These ranges of estimates reflect those provided informally by the presidents of the AAFRC, NSFR, and CBBB. On self-regulation generally, see the study prepared for the Commission on Private Philanthropy and Public Needs by Peter G. Meek, "Self-Regulation in Private Philanthropy," 1974.

300. See testimony of Helen L. O'Rourke, Director, Philanthropic Advisory Department, Council of Better Business Bureaus, in *Charity Hearings*, p. 115.

301. Ibid., p. 105.

302. IRM 4(12) 40.323(2)(d). Also, the Service's Audit Technique Guidelines issued in 1973 instruct revenue agents examining 501(c)(3) organizations that salaries paid to related parties must be "commensurate with the task performed," that expense reimbursements to individuals are not subject to withholding only if they are "bona fide ordinary and necessary expenses incurred in operating the organization," that agreements with professional fund raisers should be analyzed "to determine if they are at arm's length," and that examining agents should generally "analyze all . . . disbursements to determine that no payments are being made for the benefit of any . . . individual . . . or for purposes which do not further the organization's exempt purposes," applying "normal auditing techniques to determine that all payments furthered the organization's charitable purposes." See *Audit Technique Guidelines, Religious, Charitable, Scientific, Literary and Educational Organizations IRC 501(c)(3)*, IRS Exempt Organization Training Program (Examinations) Document No. 3152-01, January 1973, pp. 37, 43, 44. Although these guidelines were developed "primarily" as a training aid and are "not to be cited as authority for the Service's position in the administration of the tax laws," the guidelines are made "optional" for "on-the-job" use by revenue agents, ibid., p. 29.

303. Testimony of Howard M. Schoenfeld, Chief, Procedures Section, Exempt Organization Examination Branch, Audit Division, Internal Revenue Service, in *Charity Hearings* at 203; cf ibid., at 177, 202.

304. In Revenue Ruling 69-383, 1969-2 Cum. Bull. 113, the Service upheld the 501(c)(3) status of a hospital which entered, after arm's length negotiations, into a percentage compensation arrangement with a radiologist, where the compensation was reasonable and the radiologist did not control the organization. Nevertheless, the Service there noted: "Under certain circumstances, the use of a method of compensation based upon a percentage of the income of an exempt organization can constitute inurement of net earnings to private individuals. For example, the presence of a percentage compensation agreement will destroy the organization's exemption under section 501(c)(3) of the Code where such arrangement transforms the principal activity of the organization into a joint venture between it and a group of physicians (*Lorain Avenue Clinic v. Commissioner*, 31 T.C. 141 (1958)), or is merely a device for distributing profits to persons in control (*Birmingham Business College v. Commissioner*, 276 F.2d 476 (1960))."

305. Treas. Reg. §301.6104-2.

306. See testimony of Helen H. O'Rourke, Director, Philanthropic Advisory Department, Council of Better Business Bureaus, and of Howard M. Schoenfeld, Chief of the Procedures Section, Exempt Organizations Examination Branch, Audit Division, Internal Revenue Service, in

Charity Hearings, pp. 105, 208-209; Harvey Katz, *Give! Who Gets Your Charity Dollar?*, op. cit., p. 15.

307. See IRM 4(11)94, discussed at pages 2605-06 above.

308. Section 2(b)(1) also exempts 501(c)(1) corporations owned by the United States, a state, or the District of Columbia, and solicitations between and among members of an organization.

309. The Service is technically referred to in the bill as the Secretary of the Treasury "or his deregate."

310. Although not specified in the bill, termination of public charity status would presumably be followed or accompanied by revocation of 501(c)(3) status. Otherwise, the terminated public charity might remain a 501(C)(3) organization that is no longer a "public charity" subject to the act.

311. See discussion of this advisory committee at pages 2638-40 above.

312. Because section 2(b)(1) of the bill exempts virtually all organizations from the section 3 obligation to state that information will be provided on request, the overwhelming number of donors would not even know that it is available.

313. 15 U.S.C.A. §§1701-1720.

314. The Securities and Exchange Commission currently has a staff of about 1,550.

315. In introducing the Truth in Contributions Bill, Sen. Mondale expressly invited consideration of whether the Service should administer its provisons, as the bill is now drafted, or whether "requirements relating to disclosure might more appropriately be administered by another agency." 121 Cong. Rec. No. 40, March 12, 1975, p. S3757.

316. Ibid.

317. The proposed legislation, entitled "An Act to Regulate Individuals and Organizations Engaged in Charitable Public Solicitation" (referred to hereafter as the Model State Act), has not been enacted by any state.

318. Determining the cut-off point requires careful study; it might exempt just the smallest "garden club" type organizations or, for example, solicitations with a goal of several million dollars or less. Administrative workload of the new agency, a study of where abuses seem to occur, the kinds of organizations most likely to be affected, and the probable cost of compliance with the new requirements, are among the factors to consider. Also, by authorizing the new agency to specify such exemptions by regulation, an opportunity would be afforded the agency to discover by experience whether the level of a fund-raising "goal" is a practical criterion or whether, as in the Truth in Contributions Bill, the only criterion of size should be the organization's annual budget.

319. See "Mail Order Millions, Religious Groups Find Appeals Rewarding," *The Washington Post*, September 1, 1974, p. 1, September 2, 1974, p. 1, September 3, 1974, p. 1.

320. Code Section 6033(a)(2)(A)(i).

321. Treas. Reg. §1.6033-2(g)(2). The Service is currently preparing a regulation or Revenue Ruling that would define, for the first time, "integrated auxiliaries" of churches. Absent such a definition, many church-related hospitals, schools, old-age homes, etc., covered as subordinate organizations under group exemption rulings issued to central or parent church organizations,

have not been obliged to file information returns. The Service's 1974 Instructions for Form 990 give notice that such subordinate organizations will be expected to file a 1975 Form 990 unless they can themselves qualify as "a church, an interchurch organization of local units of a church, a convention or association of churches, or an integrated auxiliary of a church."

322. Code section 7605(c).

323. Alternatively, solicitation statements might be submitted to the new agency when used, without prior review; this would impose less of a burden on soliciting organizations and might simplify administration of the new agency. We're inclined to believe that prior review will enable soliciting organizations and the new agency to resolve potential problems informally and in advance, but the point needs further study.

324. Procedural rules would presumably permit more intensive and detailed study of the major nationwide solicitations, with quicker reviews of smaller regional solicitations.

325. See American Institute of Certified Public Accountants, Industry Audit Guide, *Audits of Voluntary Health and Welfare Organizations*, 1966, revised 1973.

326. See testimony of Arthur J. Grimes, Director of Membership, National Health Council, in *Charity Hearings*, pp. 27-28.

327. IRM 4(11)45.2, Manual Transmittal 4(11)00-11, issued August 29, 1974.

328. See the Accounting Advisory Committee's report to The Commission on Private Philanthropy and Public Needs "A Study of the Inadequacies of Present Financial Reporting by Philanthropic Organizations," 1974.

329. Securities Act §19(a); Securities Exchange Act §13(b). See Holding Company Act §20(a); Investment Company Act §38(a).

330. I Loss, *Securities Regulation* 333 (2d Ed. 1961).

331. 17 C.F.R. §240.10b-5.

332. The prohibition applies only to the use "of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange," but this encompasses virtually all securities transactions.

333. 15 U.S.C.A. §1703 (1974).

334. The distinction is important, but in practice it can become blurred. Organizations normally do not disclose the frauds that they are engaged in, so that an anti-fraud provision could be used to reach the failure to disclose a fraud even though it did not reach the fraud itself. This has been the experience under the securities laws; that experience can be carried over in solicitations, or the statute and regulations can be drawn more restrictively. We believe that an anti-fraud provision of some kind is a corollary to the requirement for disclosure, but the scope requires careful study.

335. Code section 507(g) was the only part of the Treasury proposal to survive; it provides for abatement of the private foundation terminaton ("wringer") tax if state officials initiate corrective action in state courts to preserve charitable assets and thereafter certify that such action has successfully been taken. This provision has virtually never been utilized.

336. See *Tax Reform Proposals Contained in the Message from the President of April 21, 1969 and Presented by Representatives of the Treasury Department to the Committee on Ways and*

Means at Public Hearings on the Subject of Tax Reform on Tuesday, April 22, 1969, 91st Cong. 1st Sess. (Comm. Print), pp. 39, 129-139.

337. These standards emerged in different form as Code sections 4941-4943.

338. "All transactions which are prohibited under existing law would be prohibited under the new self-dealing proposals. Therefore, the existing sanction of loss of exemption for prohibited transactions would be made inapplicable to transactions after the effective date." Technical Explanation of Treasury Tax Reform Proposals, April 22, 1969, in *Tax Reform Proposals*, op. cit., note 336, supra., at 138-139.

339. E.g., see *Stern* v. *Lucy Webb Hayes Nat'l Training School*, 381 F. Supp.1003 D.C. (1974) (nearly $1 million of hospital's liquid funds left on deposit drawing no interest at banks of which hospital's trustees were officers.

340. Line 54, TCMP-Exempt Organization Audit Evaluation Document (Form 5232), Attachment 1 to IRM Manual Supplement 48-G-222, September 18, 1974.

341. Code sections 6213, 7422.

342. Potential donors have no assurance that charitable contributions are deductible unless the Service has determined that the donee charity is entitled to 501(c)(3) status.

343. Similarly, it may sue for a refund of federal unemployment or social security taxes imposed on the organization as an employer.

344. In *Church of Scientology* v. *United States*, 485 F.2d 313 (9th Cir. 1973), after the organization sued for refund of taxes assessed upon the Service's denial of exempt status, the Service sought to avoid judicial decision on the merits of the organization's legal claim by administratively tendering a refund of the amount the organization "would have received (other than costs) had it prevailed" in the litigation.

345. *Bob Jones University* v. *Simon*, 416 U.S. 725, 40 L.Ed.2d 496, 516-517, 94 S.Ct. 2038, 2052 (1974). See also the dissenting opinion of Mr. Justice Blackmun in the companion case of *Alexander* v. *"Americans United" Inc.*, 416 U.S. 752, 40 L.Ed.2d 518, 528, 94 S.Ct. 2053, 2060 (1974).

346. Thrower, *IRS Is Considering Far Reaching Changes in Ruling on Exempt Organizations*, 34 J. of Taxation 168 (1971).

347. Code section 7476, as amended by section 1041 of the Employee Retirement Income Security Act of 1974, P.L. 93-406, 88 Stat. 949.

348. Testimony of Commissioner Donald C. Alexander, *Hearings Before Subcommittee on Foundations, U.S. Senate Committee on Finance*, June 3, 1974, at 167; see also IRS News Release, Remarks by Commissioner Alexander before the Council on Foundations, San Antonio, Texas, May 10, 1974. The House Committee on Ways and Means, in Press Release No. 6, May 20, 1974, tentatively agreed to provide a procedure for declaratory judgments in the Tax Court as to exempt status.

349. Remarks by Commissioner Randolph W. Thrower prepared for delivery before the Southwestern Legal Foundation, Dallas, Texas, January 15, 1971; ibid., before the South Dakota Society of CPA's and State Bar Associations, Rapid City, South Dakota, November 6, 1970.

350. *Statement of the Senate Subcommittee on Foundations Together With Additional Views*, 120 Cong. Rec. No. 150, p. S181315, 93d Cong., 2d Sess., October 4, 1974.

351. The Service's Statistics of Income Series reports the total dollar amount of charitable contributions itemized by individuals on income tax returns every second year, by income bracket, with a two-year lag in publication. The total amount of corporate contributions is reported on an annual basis, also with a two-year lag. The amount of charitable bequests has been provided on a three-year basis in the past, also with a two-year lag; following 1972 information, the Service will provide this information only on a four-year basis, i.e., next reported data will be for 1976, probably not available until 1978.

352. See Testimony of Robert F. Goheen, *Hearings Before the Subcommittee on Foundations, Committee on Finance, U.S. Senate, October 1 and 2, 1973*, p. 67; unpublished memorandum of Robert F. Goheen based on conference of AAFRC, the Council on Foundations, the Foundation Center and the Council for Financial Aid to Education, July 1973.

353. Nielsen, *The Big Foundations*, (Columbia University Press 1972), pp. 295-308. See also "Private Foundations and Public Information, *The Grantsmanship Center News* April/May 1974 (77.6% of foundations that were asked for annual reports, Form 990-ARs, and guidelines for grant applicants had not responded eight months later); "The Hospital Business," *The Washington Post*, October 29 and November 3, 1972 (hospitals reluctant to identify names of trustees or provide financial information).

354. Testimony of Alan Pifer in *Hearings Before the Subcommittee on Foundations, Committee on Finance, U.S. Senate*, 93d Cong., 1st Sess., October 1 and 2, 1973, p. 266.

355. We are grateful to Joan McC. Lundberg, until recently the editor of *Giving USA*, for many of these suggestions.

356. A survey of corporation giving to the arts in 1973, conducted by Touche Ross & Co. for the Business Committee for the Arts, indicated that about half of all corporate support of cultural activities is accounted for as business expenses, typically in advertising or public relations budgets.

357. Testimony of Commissioner Alexander in *Hearings*, op. cit., note 348, supra., at 152.

358. *Statement of the Senate Subcommittee on Foundations Together With Additional Views*, 120 Cong. Rec. No. 150, p. S18315, 93d Cong., 2d Sess., October 4, 1974.

359. See *Eastern Kentucky Welfare Rights Organization v. Simon*, 506 F.2d 1278, 1291 (D.C. Cir. 1974) (opinion of Circuit Judge Wright).

JUDICIAL REMEDIES AND RELATED TOPICS

Adam Yarmolinsky[†] and Marion R. Fremont-Smith*

Given the importance of preserving an independent private philanthropic sector, it is vital to have appropriate devices to prevent abuse while still preserving the freedom of operation that is an essential component of private voluntary action. Until recently, it has been assumed that schools, hospitals, churches, and organizations that depend upon gifts and contributions from the general public would be held accountable by their supporters and that it was only private foundations, which do not seek or depend upon public support, that needed strict regulation to assure accountability.

It is not surprising that there have been examples of irresponsibility and wrongdoing by the publicly supported charities as well as private foundations. They have misled the public on the costs of soliciting funds, endowments have been lost through imprudent speculation, and public charitable offices used for private gain. It is, therefore, appropriate for the Commission to consider and recommend measures to correct such abuses, balancing the risks of the abuse and the value of reinforcing public confidence in public philanthropy against the financial and other costs of such regulation.

The framing of meaningful rules and appropriate remedies to prevent self-dealing, misleading appeals for funds, and improper investments is not an easy task. The difficulties arise as much from the nature of the entities to be regulated as from finding the appropriate government agency to do the task. The primary focus must be on preventing private inurement, a function traditionally left to the states whose courts of equity have a wide range of powers which permit them to devise appropriate remedies for correcting breaches of trust. However, even if all of the states were willing and able to do the necessary regulating, which they are not, it would still not solve the problem of charities that deal in many states and have the ability to move from one to the other when corrective action is threatened.

At the federal level, until 1969, revocation of exemption was the only federal sanction for improper dealings by a charitable organization; but the conditions for exemption were broadly stated, and it was only in the most extreme cases of abuse that the Service would act. Most of the abuses that now need stricter regulation are difficult to control under such a system. However, since the Tax Reform Act of 1969 and in the even more recent pension legislation, attempts have been made to reframe the provisions of the Internal Revenue Code to make it a more suitable framework for control of fiduciaries: with the establishment of a separate office of Employee Plans and Exempt Organizations under an Assistant Commissioner of Internal Revenue, the specialized personnel is being assembled to make regulation of fiduciary duty through the Internal Revenue Code more effective.

The challenge is to identify those areas most in need of rectification and to devise remedies and sanctions that can be enforced within the framework of the Code and its new administrative system without having such a strong deterrent effect that they alter irrevocably the freedom of decision and operations that are necessary concomitants of philanthropy.

This paper suggests three major changes in the application of the Internal Revenue Code to organizations exempt from tax under section 501(c)(3) and discusses additional measures that would deal with solicitation of funds in the name of charity.

[†] Ralph Waldo Emerson University Professor, University of Massachusetts.

*Choate, Hall & Stewart, Boston, Massachusetts.

I

IMPROVING THE JUDICIAL REMEDIES FOR CORRECTING ABUSES AND DETERMINING EXEMPT STATUS

Until 1950 the only federal standards for exemption under section 501(c)(3) were exclusive organization and operation for exempt purposes, a prohibition against private inurement, and conformity with certain limitations on lobbying and political activity; the only sanction was revocation of tax exemption.

In 1969 Congress imposed excise taxes on private foundations and certain persons connected with them for violation of newly enacted provisions regulating their activities. It also required that the governing instruments of all private foundations thenceforth contain provisions prohibiting the now-precluded acts so that violations could be corrected in state equity court proceedings. The Code was also amended to permit abatement of the termination tax on private foundations if a state court took appropriate action to preserve the foundation's funds.

These measures were an open admission that revocation of exemption was an inadequate sanction to prevent violation of the provisions of the Code.

For public charities, however, revocation of exemption remains the only sanction available to the Service if the conditions for exemption are not observed. However, this serves only to penalize the beneficiaries of charity. It does not punish the wrong-doers. In fact, it often permits them to continue in office with greater freedom to deal with the charity's funds than before.

This situation can be remedied by investing the federal courts with equity powers similar to those of the state courts. This would include the power to rescind transactions, surcharge trustees, order accountings, remove trustees and appoint new ones, divest assets, enjoin improper actions, and appoint receivers. The courts would then be in a position to remedy any detriment to charity resulting from violation of the conditions for exemption and the substantive laws enacted to assure proper use of charitable funds. It could preserve these assets and thus prevent recurring violations.

This is not a new concept. It was suggested by the Treasury in 1969 in connection with the activities of private foundations. The study prepared for the Commission by Ginsburg, Feldman & Bress ("Federal Oversight of Private Philanthropy") ascribes the failure of Congress to adopt it to a jurisdictional dispute as to who should represent the government in the litigation. This same study sets forth the advantages of such a measure:

> "Broad federal equity powers such as proposed by Treasury are essential to supplement the present sanctions of revocation or penalty taxes. Such powers would provide flexibility to fashion sanctions that meet the exigencies of the particular case without penalizing intended charitable beneficiaries by reducing the funds available for charitable programs. The provision to stay federal proceedings pending the conclusion of parallel state proceedings would defer appropriately to state authorities to the extent that they develop effective supervisory programs."

The Ginsburg study concluded with a strong recommendation that equitable remedies be made applicable to all 501(c)(3) organizations. This is an appropriate recommendation for the Commission to adopt.

The Ginsburg study also recommended that Congress be urged to adopt a statutory right to judicial review of any organization denied section 501(c)(3) status or not granted such status within a reasonable time. This measure would fill a serious gap in the current statutory scheme that has long been recognized by the

Supreme Court, Treasury and Service officials and the private bar. It would logically form a part of the Commission's recommendations in regard to judicial review of exempt organization questions.

II

PRIVATE BENEFIT

Section 501(c)(3) recites as a condition of exemption that no part of the funds of an organization shall inure to a private shareholder or individual. Although this provision has been a part of the Code since the first income tax law was enacted, it is only in rare instances that the courts have upheld revocation of exemption because of private inurement.

This situation has left the Service essentially powerless to prevent most self-dealing transactions that are prohibited under state law but rarely enforced in the state courts. In 1950 Congress did attempt to prohibit certain self-dealing transactions between foundations and substantial contributors through section 503. This legislation followed disclosures of the private use of assets of foundations controlled by a single donor and his family or a single corporation. The provisions were not made applicable to religious organizations, schools, hospitals, and those other exempt organizations that derived a substantial part of their support from the general public and governmental units.

Under the prohibited transactions sections, certain dealings between substantial contributors and persons and corporations related to them were declared to be grounds for revocation of exemption. Forbidden were loans without adequate security and a reasonable rate of interest, payment of unreasonable compensation, preferential treatment whether through the rendering of services or purchasing of securities, selling property without adequate consideration and other acts that involved or resulted in a substantial diversion of the organization's property.

The prohibited transactions sections had serious shortcomings and were the subject of widespread criticism. Internal Revenue Service and Treasury officials claimed that the standards of "reasonableness," "adequate security," "substantial diversion" were too loose, making the law difficult and expensive to administer, hard to enforce, and otherwise insufficient to prevent abuse. By applying only to dealings with substantial contributors they omitted the important area of self-dealing between organizations and directors and officers who were not contributors. Finally, the sanction of revocation of exemption was clearly inappropriate.

The self-dealing rule adopted as part of the Tax Reform Act of 1969 reflected an attempt to rectify the shortcomings of the prohibited transactions sections. Thus, section 4941 now imposes categorical prohibitions with specific limited exceptions and, as already noted, provides for personal penalties on the self-dealer and on those foundation officers who knowingly participate in the transaction, while leaving the foundation's funds intact.

The major drawback of the self-dealing rules, in fact, is that they represent an example of overkill, penalizing persons innocently involved in actions that serve only to benefit the foundation. By applying to both direct and indirect self-dealing, they now prohibit arrangements entered into inadvertently and often under circumstances impossible to avoid. In spite of an attempt to devise strict standards, some of the rules still are framed in terms of "reasonableness," prohibit "excessive" compensation and use a standard of adequate security. The use of the terms "knowing," "willful," and "due to a reasonable cause" have further compounded uncertainty for managers anxious to abide by the rules. In fact, some commentators have suggested that it would have been preferable to retain the standards contained in section 503, changing only the sanctions from loss of revocation to penalties on the self-dealers.

The private foundation rules apply to foundation managers and disqualified persons. "Managers" are defined as officers, directors, or trustees, and "with regard to any act or failure to act, the employees of the foundation having authority or responsibility with respect to such act or failure to act." The definition of disqualified persons is extremely broad, encompassing foundation managers and, in addition, substantial contributors (more than 2 percent of all gifts and contributions if more than $5,000), the immediate families of these persons, and corporations, trusts, and partnerships owned or controlled by them.

It is far easier for private foundations to identify their substantial contributors than any large operating charity could, whether it be a university, a hospital, or a social welfare institution. Furthermore, it does not appear that the principal problem in these institutions is dealings with substantial contributors and organizations controlled by them, and the administrative burden not only of identifying such individuals and entities but attempting to police all dealings with them would be overwhelming. It is therefore recommended, at least until more evidence of abuse appears, that any new rules applicable to public charities be limited to transactions between trustees, directors, and principal officers and the organizations they serve, thereby including only those persons with final responsibility for and control of the organization's assets. For purposes of this paper, the individuals to whom the provisions would apply are called "Trustees," following the pattern of the Uniform Supervision of Charitable Trustees Act in force in several of the states.

Defining the acts to be prohibited requires balancing a desire to prevent private inurement by what are essentially insiders with the desire to permit those transactions that are necessary to the easy and proper functioning of the institution or that would cause it detriment if they were to be discontinued. We do not want public charities paying excessive salaries to officers and directors, purchasing goods from them at prices higher than could be charged elsewhere, paying higher commission through their brokerage house than their competitors charge, or higher rent in a building owned by them than they would pay elsewhere. On the other hand, if the rent is at the prevailing rate, or the commission is the same or less than that charged by other brokers, the public charity should be able to participate in the transaction. In short, it is not necessary or desirable to establish absolute prohibitions against all transactions between public charities and their managers. Nor at the outset would it be advisable to attempt to prohibit "indirect" self-dealing as this could well be used by overly zealous officials to subvert the intent to deal with a limited group of prohibited acts.

Accordingly, the Commission should consider recommending that the following acts be prohibited:

any sale or exchange or lease between a public charity and a trustee at higher than fair market value;

any lending of money or extension of credit by a public charity to a trustee;

any borrowing of money from a trustee other than at a reasonable rate of interest or with no more than adequate security;

any payment by a public charity to a trustee of unreasonable (or excessive) compensation;

any furnishing of goods, services, or facilities by a public charity to a trustee on a preferential basis or by a trustee to a public charity at higher than fair market value.

In order to mitigate uncertainties that will inevitably arise in connection with the standards of reasonableness, it is recommended that in any instance in which a trustee has a conflict between his interests and those of the charity, there should be a presumption that any action taken by the charity is in its best interest if the matter has been fully disclosed to the charity and considered and voted upon solely by those trustees who are disinterested with respect thereto, and the disclosure, consideration, and decision are appropriately reflected in the records of the charity. In such instance, the burden of overcoming the presumption that the transaction was proper would be on the Service.

It is also recommended that a provision be included permitting certain special exceptions of both persons and transactions in the discretion of the Secretary of the Treasury after notice of opportunity for a public hearing. A provision of this nature is now part of the prohibited transactions section of the Code dealing with employee retirement income security plans and has already proved beneficial to persons affected as well as the Treasury.

Consideration should be given to whether prohibitions are to be applied to both the self-dealer and those other members of the board who approved the transaction, as is the case in regard to self-dealing by private foundations, or only on the self-dealer and not on a manager or fiduciary acting as such, as is the pattern in the pension legislation. The penalties for violation of these provisions could be excise taxes similar to those applicable to private foundations or reliance on the equitable remedies discussed in the first section of this paper. Enforcement through use of equity powers would provide the most appropriate remedies, the major drawback being that in cases with small amounts involved there may be a reluctance to initiate judicial proceedings and thereby undercut the impact of the rules. A possible solution would be imposition of a mandatory initial excise tax of a minimal amount and referral to the courts under equity powers if there is no correction or restitution.

III

SPECULATION

Just as trust law has developed limitations on the extent to which fiduciaries can risk funds of others that are entrusted to their care, there is no reason why the federal government should not require that funds donated for tax-exempt charitable purposes should not be so invested or used that they could be lost. Since 1969, private foundations and their managers responsible for investments are subject to excise tax if they invest the foundations's funds in a manner that would jeopardize the carrying out of the organization's exempt purposes. There is no reason why this rule should not apply universally to all 501(c)(3) organizations. It is true that public support may not be forthcoming if a large portion of the funds are lost, but in most cases this may not be known by individual contributors and, if it should become known, it will often be too late to recover the improperly invested funds. These activities are now prohibited in connection with private foundations under section 4944, which imposes a tax on the fiduciaries of a charity who authorize an investment knowing that it is jeopardizing the carrying out of the organization's exempt purposes. A similar prohibition should be extended to all organizations exempt under section 501(c)(3). The prohibition against speculation would not extend to program related investments. As will the self-dealing prohibition, the sanctions could be either court-imposed equitable remedies or penalty taxes or a combination of the two.

IV

SOLICITATION

Several recent congressional investigations have highlighted the nature of improper solicitation practices and the difficulties of controlling them. There is evidence of fraud, of use of misleading names, of profit-making organizations that imply they are raising funds for charity, of tax-exempt organizations created by business corporations to serve as outlets for sale of their products, and of false advertising practices. There is also the problem of organizations that spend as much as 90 percent of their receipts for costs of solicitation. In some cases this may be due to mere inefficiency, in others to purposeful use of charity for personal gain.

There are many regulatory programs in the states and some in cities and counties. Often, however, the administrators find themselves powerless to act against organizations that move out as soon as investigation is threatened or operate simultaneously in several states, making only partial disclosure in each one.

It is these difficulties that have led to suggestions for federal control of improper solicitation. Specific recommendations, however, reflect two different approaches to the problem. Some believe that there should be an absolute limit placed on the amount of funds that can be expended for solicitation. Others, however, feel that this is not a proper matter for federal regulation and what is needed is dissemination to potential contributors of information on the cost of solicitation. The Truth in Contributions Act submitted to Congress by Senator Mondale represents a combination of the two by establishing a 50 percent limit on administrative costs (including those for solicitation) to be policed by the Internal Revenue Service through imposition of a penalty tax on the charity for violation. It also requires dissemination to all persons solicited of a disclosure statement, approved in advance by the Internal Revenue Service, indicating the costs of solicitation.

The study prepared for the Commission by Ginsburg, Feldman & Bress concluded that mandatory dissemination of a disclosure statement to persons being solicited was the optimum method of control and that the Internal Revenue Service was not the proper agency to regulate solicitation practices. It recommended establishment of a new agency within the Treasury Department, modeled on the lines of the Securities and Exchange Commission, with which soliciting charities would file full reports of their expenditures and which would be empowered to conduct audits, enjoin improper activities, and give advance approval to disclosure statements.

One of the major difficulties with this suggestion is the fragmentation that would result from having two separate agencies regulating charitable activities. The Commissioner of Internal Revenue has expressed this view and indicated a preference for assigning to the Service whatever regulation of solicitation is adopted.

We propose adoption of three specific measures designed to control the more flagrant abuses in solicitation without requiring establishment of a new federal regulatory agency and without unduly burdening the great majority of publicly supported charities who do not abuse their public trust when soliciting funds. These three measures are:

1. Adoption of uniform accounting procedures and full disclosure of costs of solicitation to the Internal Revenue Service.

2. Mandatory notification to all persons solicited of the availability of financial data.

3. Expansion of the Federal Trade Commission's ability to regulate improper and misleading techniques of solicitation.

Uniform Accounting and Full Disclosure to Internal Revenue Service

Adoption of uniform accounting procedures and full disclosure to the Internal Revenue Service of solicitation costs are necessary first steps regardless of what other measures are adopted. A federal requirement is the only feasible method for achieving uniformity and therefore the ability to make meaningful comparisons. However, efforts at self-regulation in this area which have been made in the last decade should not be thwarted. Accordingly, the Secretary of the Treasury should be authorized to permit, by regulation, submission of accounts based on uniform accounting procedures that are already widely used within a given field of philanthropy in those instances where they do provide sufficient disclosure for understanding the true costs of solicitation and for making comparisons among organizations.

Availability of Information

As between a fixed percent limit on the cost of solicitation and the use of disclosure as an indirect means of regulation, we believe that the disadvantages of imposing fixed limitations far outweigh the benefit of protecting the public from inefficiency and that, at least until more evidence of widespread abuse appears, this should be a matter for state action.

Nor can we justify the administrative burden and financial costs of compliance with a requirement that full disclosure of costs be made with every solicitation. As an alternative we recommend that all solicitation material contain a statement to the effect that a copy of the financial report of the organization is available on request at its offices. This could be enforced by the Internal Revenue Service in a manner similar to that now applicable to the availability of private foundation annual reports, namely, that failure to make such a statement or to comply with the disclosure requirement on request will subject the managers of the charity to personal penalties. The reports must, of course, also be available from the Internal Revenue Service, and without the cost and delay now connected with obtaining Form 990.

Federal Trade Commission

Finally, we recommend that the Federal Trade Commission's power to regulate unfair and deceptive acts and practices be expanded to include improper and misleading techniques of solicitation by both profit-making and tax-exempt organizations. The Federal Trade Commission Act declares unlawful all "unfair methods of competition . . . and unfair or deceptive acts or practices in or affecting commerce" and instructs the Federal Trade Commission to take action against any "person, partnership, or corporation" that employs such practices, "if it shall appear . . . that a proceeding . . . would be to the interest of the public . . ."

The procedures under which the FTC acts are particularly appropriate for control of improper solicitation practices. It has broad investigative powers, extending to cases of alleged violation of specific acts. It may also require entire industries to file special reports concerning matters pertaining to possible violations and may publish more portions of its accumulated information deemed in the public interest.

If a violation appears to have occurred, the commission proceeds by issuance of a complaint which is then heard before an administrative law judge. This is an adversary hearing with the rights of all parties protected. The finding of the trial judge becomes final unless appealed. Initial appeals are heard by the commission as a body, and there is a further right of appeal to the United States Court of Appeals.

Noncompliance with Federal Trade Commission orders can lead to imposition of fines and possible criminal prosecution against those responsible.

In addition to these adjudicative powers, the FTC has the authority to promulgate trade regulation rules, which make certain acts or practices illegal per se. Knowing violations may be punished by civil penalties. The FTC may also issue less formal, industry guides which are meant to inform interested parties of the FTC's view on certain practices in various industries.

The Federal Trade Commission has established that misrepresentation of business status is an unfair or deceptive practice within the meaning of the act. Under this rubric, the Federal Trade Commission has successfully prosecuted profit-making enterprises that misrepresent themselves as nonprofit. Thus, there have been several instances in which the FTC has enjoined profit-making organizations from claiming to be affiliated with, or actually to be, charitable organizations.

However, the FTC's authority over nonprofit corporations is hampered by the definition of "corporation" in §4 of the act. It provides:

> 'Corporation' shall be deemed to include any company . . . or association, incorporated or unincorporated, which is organized to carry on business for its own profit or that of its members, and has shares of capital or capital stock . . ., and any company . . . or association, incorporated or unincorporated, without shares of capital or capital stock . . ., except partnerships, which is organized to carry on business for its own profit or that of its members.

Three recent decisions have interpreted this language as being sufficiently broad to permit the commission to prosecute "non-profit organizations which were merely vehicles through which pecuniary profit could be realized," as well as nonprofit organizations established by and designed to provide indirect benefit to profit-seeking entities. However, the necessity of proving actual private benefit before it could assume jurisdiction is a sufficient deterrent to commission action to suggest the advisability of amending the Federal Trade Commission Act to make it clear that the commission's jurisdiction extends to tax-exempt charitable trusts and corporations involved in soliciting funds from the general public. It is of interest that in a 1972 case involving two charitable organizations purportedly created as guidance and counseling organizations to care for homeless boys and to train teachers, the trial examiner recommended congressional action of this nature.

There is a further deterrent to reliance on the Federal Trade Commission that makes congressional action desirable, namely, that the Federal Trade Commission's function is limited to matters "in or affecting commerce." To date virtually all of the actions brought by the FTC involve the sale of some form of product. Since only a portion of charitable solicitations involve sales, the argument might be made that commerce is not affected. Legislation declaring congressional intent that the FTC's jurisdiction includes all charitable solicitations whether or not they involve the sale of items would solve this problem. It would also answer a further difficulty raised by virtue of the autonomy enjoyed by the FTC in regard to the specific areas in which it will commence investigations or issue rulings. The Federal Trade Commission Act does state that investigations and inquiries may be originated upon the request of the President, Congress, governmental agencies or the Attorney General, upon referral by the courts, upon complaint by members of the public, or by the commission on its own initiative. However, the actual decision to proceed lies with the commission and its staff. Congressional action explicitly clarifying and expanding the jurisdiction of the FTC to encompass solicitation practices would in itself be a clear signal of its desire to have the commission become more active in this field. Most effective, of course, would be an increase in the appropriations for the commission earmarked to permit the establishment of a department or division exclusively concerned with organizations seeking funds through public solicitation.

THE STATUS OF STATE REGULATION OF CHARITABLE TRUSTS, FOUNDATIONS, AND SOLICITATIONS

Office of the Ohio Attorney General[†]

Introduction and Summary Findings

Charitable Trusts and Foundations

While it is true that the regulation of charitable trusts began in England long before the Statute of Elizabeth in 1601, the American phase of this regulatory function did not begin in earnest until the 1940s and 1950s. Prior to that time, although the common law powers of the state attorneys general would have been sufficient for most regulatory purposes, at least in terms of remedial action, the parameters of the common law were vague. This fact retarded the development of a unified, easily accessible body of law because each extension or clarification of the attorney general's enforcement authority required litigation. It was not until the 1950s that this piecemeal process came to a halt with the enactment of several charitable trust statutes.

During the decades between 1940 and 1960 there were a number of factors which coalesced to such an extent as to make the political arena aware of the need for a systematic and comprehensive body of law concerning charitable organizations. The initial factor which produced this awareness and which eventually lead to the adoption of specific legislation was Austin Scott's initial treatise on the law of trusts which was published in 1939. It was Scott's conclusion that while the state attorneys general possessed the common law authority to enforce charities, they lacked the necessary information to fulfill their duties. New Hampshire acted on Scott's suggestion and adopted the first charitable registration and reporting statute in the country. This legislation was to serve as the model for Rhode Island, Ohio, South Carolina, and Massachusetts, which enacted similar legislation.

In 1954 the movement toward regulating charitable entities received further impetus when the National Conference of Commissioners on Uniform State Laws proposed a model registration and reporting act entitled "The Uniform Supervision of Trustees for Charitable Purposes Act." Shortly thereafter, several law review articles appeared, which not only reviewed the Uniform Act, but also examined several aspects of charitable trust legislation.[1] The conclusions of these articles were clear: although some reform had begun, there was an overwhelming need for further movement in that direction.

One of the reasons for the lack of development of the regulation of charitable trusts and foundations is the lack of public awareness of the need for such regulation. This is due in large measure to the fact that the public is too far removed from the charitable trustee or foundation manager. Articles addressing the need for state regulation reach a very limited audience which at best includes individuals already active in the field.

Another factor which has retarded the development of charitable trust legislation is the lack, even today, of a unified body of law which speaks specifically to "charities." As noted by Marion Fremont-Smith and Professor Karst there is no "law of charities."[2] The subject matter draws equally upon trust and corporation law, and this factor has resulted in very weak statutory provisions. Even the 1954 Uniform Law contains a definitional section which excludes from its provisions those institutions which hold funds for their own purposes. This has created numerous problems, foremost of which is the question of whether charitable corporations are included within the scope of the act. That particular provision in the Uniform Act, which was adopted practically nationwide, has caused more than one assistant attorney general to tread lightly because the ground is not that firm.

[†] William J. Brown, Attorney General; Donald A. Antrim, Assistant Attorney General; J. John Stevenson, Chief, Charitable Foundations Section; Joseph M. Paul, Assistant Chief, Charitable Foundations Section.

Despite the problems, however, the status of the law is such that any state attorney general could become active in the regulation of charitable trusts and foundations. A majority of states do practically nothing in fulfilling their obligation to the public of safeguarding the billions of dollars controlled by charitable trusts and foundations in this country. As the Ohio Attorney General's survey has all too clearly indicated, the state regulation of charitable trusts and foundations has with very few exceptions, remained dormant since the colonial period. There are signs of a growing interest in the area by a number of states (most notably Arizona, Wisconsin, Nevada, and Virginia).

Although the state attorneys general are overwhelmingly recognized as the appropriate state regulatory agency for the enforcement of charitable trusts and foundations it is the exception rather than the rule that the attorney general exercises any supervisory function. Even in those states which do employ personnel to carry out this function they are usually understaffed. In fact there are a number of states which indicate that they have no staff at all for this purpose, even though they recognize the attorney general as the appropriate regulatory agency.

Given the nature of modern foundations and charitable trusts as financial institutions, the problem of inadequate staffing is compounded by the fact that relatively few states employ accountants to examine the financial data that is received. It certainly must be realized that there is more to the regulatory function than merely filing law suits.

It is apparent that registration and reporting requirements are crucial to the regulatory function. The conjunctive "and" between registration and reporting requirements cannot possibly be overemphasized. Registration forms provide the attorney general, or any other regulatory agency, for that matter, with essential information concerning the organizational structure of the foundation or trust and the identity of persons responsible for its operation. The reporting forms indicate how the entity has performed over a given period of time. It is periodic reporting and not registration which provides the basic information about how the affairs of the foundation or trust have been handled. Therefore, the registration and reporting requirements are complimentary and must appear simultaneously if any regulatory endeavor is to be at all effective.

Despite the emphasis given to the necessity of having reporting and registration forms there are only 13 states that require registration and only 15 that require annual reporting to the attorney general. Other states have requirements that testamentary trustees file accountings with the appropriate probate court, but this requirement is of no value to the enforcement authority if the information is not reported to the attorney general. Furthermore, such requirements apply only to testamentary dispositions. Therefore, it avoids practically all of the modern-day foundation community.

Of equal importance is the fact that the reporting, registration, and enforcement functions be contained within the same state agency. While the regulation of charitable entities cannot be characterized as being a rigid bureaucratic structure, it is imperative that it does not become so.

The regulation of charitable trusts and foundations is even less organized on the local level than on the state level. Since very few records are kept and there is very little coordination of effort, it is practically impossible to determine what role local municipalities play in the overall regulation of charitable trusts and foundations. At best, the regulatory role of municipalities can be characterized as sporadic.

The Tax Reform Act of 1969 opened new vistas for state regulation and may well be the final factor necessary to make the states aware of their public responsibilities. However, it created several problems along with its beneficial aspects. The primary problem existing in federal-state relations, as far as the regulation of charitable trusts and foundations is concerned, is one of duplication of effort. When the 1969 Tax Reform Act was adopted it imposed upon private foundations the requirement that certain Internal Revenue Service forms be filed with the appropriate state enforcement agency. This provision, more than any other factor, produced an awareness by the states of some vague estimate of the amount of charitable dollars and charitable entities within their respective jurisdictions. At the same time that private foundations were required to report to the state enforcement authority, public foundations were excused from that responsibility. Furthermore, the Internal Revenue Code provision, which proscribed certain transactions on the part of public foundations, was repealed.

In addition to having private foundations report directly to the states, the Internal Revenue Code provides that the states shall be notified of a revocation of exemption. This determination is extremely important to the state enforcement officials because it may signify self-dealing, excessive business holdings, jeopardizing investments, or the like. However, until this determination is made by Internal Revenue and all administrative review is completed, there is no flow of information between state and federal officials. This procedure is fraught with the potentiality of needless duplication and delay.

While there is no one solution for all of these difficulties, there are a number of guidelines and specific recommendations which, if followed, will bring the regulation of charitable trusts and foundations into the twentieth century. In the form it was proposed in 1954, The Uniform Supervision of Trustees for Charitable Purposes Act has fulfilled the basic regulatory needs of those states that have adopted it. With a few revisions to that act and with the initiation of certain procedures at the federal level, the various state attorneys general can become better equipped to regulate charitable trusts and foundations.

Charitable Solicitations

The regulation of charitable solicitations presents many of the issues encountered in the regulation of charitable trusts and foundations, although there are definite dissimilarities. Historically, the power of the attorney general over charitable trusts and foundations encompassed regulatory authority over charitable solicitations. This regulatory authority was directed primarily at the solicitation activities of the organized church as it existed in England. With the demise of the church as the principal soliciting organization both in England and the United States, and the increasing appearance of the professional fund raiser, a regulatory vacuum was created. The question arose whether the attorney general's authority should be expanded to include this new institution or whether regulatory authority should be vested in an alternate state agency. The modern trend has been to vest this authority in an alternate state agency while leaving enforcement authority in the office of the attorney general.

At the present time a total of 31 states have enacted charitable solicitation statutes. Only five of these statutes place both administrative and enforcement authority in the office of the attorney general (administrative authority in the sense of supervisory duties concerning registration and reporting requirements and enforcement authority in the sense of initiating legal actions). Twelve of the 31 solicitation statutes place only enforcement responsibilities in the office of the attorney general while placing administrative duties in some alternate state agency, predominately the secretary of state or some appropriate subdivision thereunder.

In contrast to the regulation of charitable trusts and foundations, local regulation plays a much greater role in the regulation of charitable solicitations. While only 6 states report local regulation concerning charitable trusts apart from the various probate courts, nearly half of the 38 states responding to the Ohio Attorney General's questionnaire indicate regulatory activity on the part of local governmental units. The predominate form of this local regulation is through the enactment of door-to-door solicitation ordinances. Due to the fact that record keeping is practically nonexistent at the local level, it is impossible to determine the effectiveness of this particular form of regulation.

Although a regulatory scheme may exist (statutorily or by common law) it is dependent upon the staff which enforces it. Of a total of 24 states indicating that the attorney general has either enforcement or full regulatory authority including enforcement powers over charitable solicitations, only 18 states indicate that there is a staff attorney assigned on a full-time basis. Only seven of these states report that the staff attorney actually devotes full time to the position. It is apparent, therefore, that most states are woefully understaffed for the purpose of regulating charitable solicitations.

Apart from the issue of adequate staffing, registration and reporting requirements are equally important. Given the essentially transient nature of professional fund raisers and solicitors, it is important that the state enforcement agency, whomever it may be, impose registration and reporting requirements. Fortunately, nearly all of the state solicitation statutes have such requirements.

One of the greatest potential problems in the regulation of charitable solicitations is the division of regulation between two different state authorities. In a number of jurisdictions registration of both charitable organizations and professional fund raisers is accompanied by filing the proper form with the secretary of state or some other state agency, while enforcement of violations is retained by the attorney general. While the split function does not at present seem to be a problem, it certainly leaves the door open to bureaucratic time delays. Since the professional fund raiser has the ability to move between states with relative ease, time delays can become one of the most harmful elements blocking effective regulation. It is necessary, therefore, that enforcement, administration, and investigation be the responsibility of one agency.

Overall, the role of the attorney general in the regulation of charitable solicitations is far less than his role in regulating charitable trusts and foundations. This is due primarily to the emphasis on the potentially fraudulent aspects of charitable solicitations.

While it is true that the role of the attorney general is relatively minor in the enforcement of charitable solicitations, it is also true (with few exceptions) that other state agencies do not exercise this responsibility. Therefore, it must be concluded, on the basis of the survey, that a considerable number of states do relatively little or nothing to safeguard charitable donations.

Specific Recommendations

Charitable Trusts and Foundations

1. The Uniform Supervision of Trustees for Charitable Purposes Act as revised in this report should be considered by the states as an alternative to existing legislation.

The various state governments should consider adopting a unified statutory scheme for the regulation of charitable trusts and foundations in order to fulfill their public responsibility of safeguarding charitable funds. When adopted, the act should include an expanded definitional section which clearly includes within its scope corporations holding funds for their own purposes but which are nevertheless charitable in nature. The provisions for registration and reporting must be preserved and actively utilized. In no event should there be a separation of responsibility between the agency receiving the registration and reporting forms and the enforcement agency.

2. The state regulatory body must be adequately staffed.

While it is generally recognized that the attorney general is the appropriate regulatory agency where charitable trusts and foundations are concerned, it is far from essential that the responsibility be vested in this office. Whatever state agency is eventually given the responsibility of regulating charitable trusts and foundations, it is imperative that this agency be staffed with full-time attorneys and accountants. The absence of accountants forces the regulatory body to rely on some other state agency for the review of the financial data received. In creating such a situation or in permitting it to exist, the potential for bureaucratic time delays is limitless. Furthermore, should local politics become involved in such a bureaucratic structure, the potential for a breakdown in cooperation, which is essential for an effective regulatory scheme, is entirely probable.

3. Liberalization of information exchange between state and federal agencies.

While the Tax Reform Act of 1969 has contributed more than any other factor in recent times in bringing about effective regulation of charitable trusts and foundations, there are administrative procedures which must be altered if this progress is to continue. Public foundation reporting forms, particularly Form 990's, must be sent to the state regulatory agency if public charitable funds are to be adequately supervised and protected. The information flow between the states and the Internal Revenue Service must be increased and expanded to include basic investigative material if the present duplication of effort and expense is to be avoided.

4. Adoption of uniform accounting procedures.

Standard accounting procedures must be adopted in order to avoid additional costs to the foundation community and to facilitate the flow of information between state regulatory agencies and the federal government.

Charitable Solicitations

1. The Model Solicitations Act as revised in this report should be adopted.

Although a majority of states have adopted charitable solicitations legislation, a number of these statutes fail to include several important provisions. At a basic minimum, a solicitation statute must include a provision for both registration and periodic reporting; mere licensing is insufficient. In addition, subpoena power must be granted to the regulatory agency performing the supervisory function.

2. The blanket religious organization exemption found in state charitable solicitation statutes must be examined and revised so that initial information can be obtained concerning religiously affiliated solicitations.

Despite the hands-off attitude of most regulatory agencies concerning religiously affiliated organizations that solicit publicly, there are permissible limits to which the states can and must go in safeguarding charitable donations.

The present attitude and statutory language prevents even the most cursory review of any organization that claims religious affiliation. Without making any value judgment as to the worthiness of the religious cause, the state solicitation statutes should be modified to include within their scope all religious organizations that solicit publicly. Thereafter, narrowing exemptions can be built into the statute to prevent the charge that the state has violated constitutional limitations.

3. Uniform accounting procedures must be adopted.

At the present time charitable organizations and professional fund raisers which solicit in several states must comply with varying registration and reporting requirements. These requirements differ tremendously, adding to the costs incurred by soliciting organizations and thereby reducing the funds available for charitable purposes. The basic accounting principles underlying these various forms must be standardized to reduce this burden and increase the ease of information flow between all parties concerned.

4. Administrative and enforcement duties must be placed in the same state regulatory agency.

The bureaucratic problems inherent in the regulatory process which requires the filing of documents in one state office and the enforcement by another are many. Whether the attorney general or the secretary of state is the appropriate regulatory agency within any given state is of no consequence so long as he has full regulatory powers. The split function between agencies forebodes a further retarding of the regulatory process rather than its advancement, and those states presently operating under such a scheme ought to amend the process.

I

THE REGULATION OF CHARITABLE TRUSTS AND FOUNDATIONS

The Common Law Power of the Attorney General With Respect to Charities

The common law authority of the attorney general to regulate charities had its origin in England prior to the colonization of America. This power was derived as an incident of the prerogative power of the King acting in his capacity as *parens patriae*,[3] but eventually became what could more accurately be described as an incident of the inherent jurisdiction of Courts of Chancery over all charities.[4]

Despite some historical debate to the contrary,[5] the common law system of regulating and enforcing charitable dispositions by the attorney general on behalf of beneficiaries (that is, the public) existed both prior to and after the enactment of the Statute of 43 Elizabeth, ch. 4, in 1601.[6] Early American case law treated the English Statute of Elizabeth as the foundation for the enforcement of charitable purposes.[7] It followed, therefore, that if the colonies rejected the laws of England, as many did following the American Revolution, there would be no authority for the enforcement of charitable trusts. American courts of the early nineteenth century, after an initial period of disagreement, eventually decided that charitable trusts could be enforced under the inherent jurisdiction of equity without regard to whether the Statute of Elizabeth was in force.[8]

It is now generally conceded that the Office of Attorney General was established in America during the colonial period with all of its common law powers intact.[9] Most states, however, have made no attempt to precisely enumerate the powers and duties of the office by statute. A majority of states that have considered the issue have determined that the attorney general retains all of his common law powers and duties unless expressly limited by statute. In all, 23 states have so held. The usual rule is that the legislature may expressly diminish these powers, but Illinois and South Dakota have held that the legislature may only add to his existing powers. (For a representative list of cases see Appendix A.) Likewise, very few judges or commentators have attempted to enumerate the extent of those powers. It is generally conceded that within these common law powers the attorney general possesses the power to enforce charities; and 28 states have specifically so determined. (For a selected list of the cases in these states see Appendix B.) The courts have adopted the rationale that an officer of the same title who exercises, in many respects, the same powers and performs duties similar to that of the attorney general in England should be considered to possess all of the common law powers of that officer. It is also the general view that the attorney general retains his common law powers with respect to charities even though he has been granted similar or overlapping statutory powers by the legislature.[10]

Those few states that expressly reject the attorney general's common law power to enforce charities have done so on the basis that the attorney general has no prerogative powers.[11]

The jurisdiction of the courts in this country with respect to charity often extends to matters which would have required the exercise of prerogative power under English common law. Those charities which were created or existed without a formal trust agreement required the prerogative power of the King of England for enforcement. Those trusts and charities which resulted from a formal trust instrument were restricted to enforcement by the judicial power of the Courts of Chancery. In England, prior to the colonization of this country, the Courts of Chancery had already assumed jurisdiction over charities whose regulation had previously required the exercise of the King's prerogative power. This expanded jurisdiction was transferred to the early American equity courts.[12]

Strictly speaking, there is no prerogative power in this country since no individual or body exercises personal jurisdiction over charities. Moreover, the attorney general is not regarded as personally possessing any prerogative powers, since in a democracy the state is the *parens patriae* and any prerogative power, were it to exist, resides in the legislature. This legislative power, at least with respect to charities, is more symbolic than real since American legislatures, unlike English Kings, do not personally correct abuses in the administration of charities. Rather, the attorney general, acting on behalf of the public, brings the matter before the courts for an adjudication. He does not act in a prerogative sense because he in no way dictates the outcome of the case. Therefore, if the courts provide an equitable remedy, then, in the absence of an express legislative declaration to the contrary, the power of the attorney general to bring charitable matters before the court should not be questioned.

Many courts have stated that the attorney general is not only empowered to enforce a charitable trust, but is also a necessary party to any action affecting a charitable trust.[13] The Pennsylvania Supreme Court has stated that the attorney general is obliged to participate as a necessary party since only an ". . . inadequate form of government . . . would allow organizations to declare themselves charitable trusts without requiring them to submit to supervision or inspection."[14]

There are two aspects to charitable trusts which make enforcement by the attorney general imperative. The first is the fact that the beneficiaries are an undefined class who do not have the capacity to represent themselves. The second is the fact that in all charitable trusts there are public interests which must be protected, and who is better equipped to carry out this function than the state attorney general? The general rule is that the public nature of the trust rather than its charitable nature makes the attorney general a necesary party.[15] However, if there are persons who have a special interest in the enforcement of the charity, then they may also bring suit.[16]

The precise limit of the attorney general's common law powers is defined by the equity jurisdiction of the courts. Many cases, however, have stated that the attorney general possesses the common law authority to intervene by suit in any case where the interest or property of the public is involved.[17] Under such a broad conception of his powers, it should make little difference whether the charity he is seeking to enforce is in trust or not. If there is a legitimate public interest involved, and if there is a remedy available in equity, then the power of the attorney general to bring the suit is unquestionable. Marion Fremont-Smith has stated, in her definitive work on charities, *Foundations and Government*, that the ". . . enforcement duty of the state extends to all funds held for charitable purposes whether or not a formal trust has been created."[18] This is certainly the logical rule, and the courts have carried it into effect by enforcing all types of charities. At least two cases have upheld the right of the attorney general to bring an action seeking the proper administration of a fund raised through charitable solicitations.[19] Many cases have also upheld the power of the attorney general to enforce gifts to charitable corporations.[20]

In several instances, the common law power of the attorney general over charities has been found adequate to support actions which were largely administrative. In particular, two cases have acknowledged the attorney general's power to request from trustees information and records relating to the administration of a particular trust in the case of alleged mismanagement or breach of trust.[21] It has been held, however, that the attorney general may not require a continuing communication of information in the absence of a statute.[22] Nevertheless, Marion Fremont-Smith noted that the Attorney General of Hawaii ". . . has set a precedent among the states by requiring the submission of accounts of charitable trusts to his office under his status as *parens patriae*."[23] Thus, in at least one jurisdiction, the attorney general's common law power to enforce charities has been interpreted as logically encompassing the power to compel trustees to submit regular reports.

If, as the foregoing seems to indicate, the common law has provided the attorney general with sufficient authority to regulate and supervise charity, is it necessary for the adoption of any legislation dealing with that power? The answer is clearly in the affirmative. The reason for such legislation supplanting or complimenting the common law is that it should not be necessary to resort to the courts each time a dispute arises over whether or not the attorney general has the power to take appropriate action. It serves neither the purpose of the attorney general nor the charity.

Comparative Analysis of State Charitable Trust and Foundation Statutes

In analyzing and comparing the various state charitable trust acts, it became clear that all were very similar. First, in a majority of states the attorney general is generally named as the enforcing authority: 39 states either directly or indirectly grant this authority to the attorney general. In Ohio, for example, the statute provides that "The attorney general shall institute and prosecute a proper action to enforce the performance of any charitable trust. . . ." Ohio Rev. Code §109.24 (1953). The California statute similarly provides: "This article applies to all charitable corporations and trustees holding property for charitable purposes over which the State or the Attorney General has enforcement or supervisory powers." Cal. Govt. Code §12581 (1959). A more indirect reference to the enforcement authority of the attorney general can be found in the Mississippi Code which refers to prohibited acts in the administration of private foundations. This statute reads: "Nothing. . .shall impair the rights and powers of the courts or the attorney general of this state with respect to any trust." Miss. Code Ann §91-9-409 (1972).

Second, the more comprehensive statutes specifically give the attorney general the power to institute suits to enforce a charitable trust. An example of such a statute is Ohio Revised Code §109.24, quoted above.

Third, there is a requirement that the charitable trust be registered with the attorney general. Registration is generally accomplished by filing forms prescribed by the attorney general, together with a copy of the document providing for the creation of the trust. For example, New Hampshire provides for registration in the following manner:

> In addition to his common law and statutory powers the attorney-general shall have the authority to prepare and maintain a register of all charitable trusts heretofore or hereafter established or active in the state. N.H. Rev. Stat. Ann. §7-19 (1955).
>
> The attorney-general shall make such rules and regulations as may be reasonable or necessary to secure records and other information for the operation of the register and for the supervision, investigation and enforcement of charitable trusts. N.H. Rev. Stat. Ann. §7-22 (1955).

The New York Statute provides that

> The attorney general shall establish and maintain a register of all trustees containing such information as the attorney general deems appropriate, and to that end may conduct such investigations as he deems necessary. . . ." N.Y. EPTL §8-1.4(c) (1966).
>
> Every trustee shall file with the attorney general, within six months after the property held by him or by any income therefrom is required to be applied to charitable purposes, a copy of the instrument providing for his title, powers and duties. N.Y. EPTL §8-1.4(d) (1966).

The overall purpose of registration requirements is to inform the attorney general of the existence of charitable trusts and foundations within his jurisdiction in order that the remedial provisions of the act may be accomplished. At the present time a total of 14 states require registration.

Fourth, there is a requirement that there be some form of periodic financial reporting to the enforcing authority. This usually takes the form of reporting assets, expenditures, and other financial information associated with the administration of the trust. Basically, there are two types of reporting provisions. One type calls for periodic reporting to the probate court. The second type requires that the periodic report be sent to the enforcement authority, namely the attorney general. These requirements are not mutually exclusive, particularly in the case of testamentary dispositions which are initially subject to the probate court's jurisdiction. Where, however, the probate court does not have jurisdiction over the subject matter of the trust or the trustees due to the fact that the disposition was inter vivos, the only periodic reporting would be to the enforcement authority if such a statutory requirement exists. For example, a Vermont statute requires that the periodic report be made to the probate court indicating ". . .the property so held and administered, the receipts and expenditures in connection therewith, the whole number of beneficiaries thereof and such other information as such court may require." Vt. Stat. Ann. §13.1-205 (1971). The state statutes which require that a periodic report be made to the enforcing authority are exemplified by the Ohio statute which provides:

> Any trustees of a charitable trust shall biennially, unless otherwise directed by the attorney general, make to him a written report for the two preceding fiscal years of such trust showing the property so held and administered, the receipts and expenditures in connection therewith, and such other information as the attorney general may require. . . . Ohio Rev. Code §109.31 (1953).

Marion R. Fremont-Smith in *Foundations and Government* considers the use of a reporting requirement to a court, without a complimentary registration requirement, as creating a weakness in the enforcement scheme, a position with which most active regulators would agree. After noting a lack of compliance with the reporting statute in Vermont, Fremont-Smith stated: "The reasons for failure lie in the fact that without any further means of identifying these trusts at the time of creation, it is impossible to tell where there is delinquency (in reporting) . . .[24] If there are both registration and periodic reporting requirements, and if both are required to be sent to the enforcing authority, there is a better chance of obtaining effective enforcement. At the present time 34 state statutes impose some form of registration and/or reporting requirement upon charitable trustees and foundation managers. Of the 34, only 13 require that the registration and/or periodic report be filed with the enforcement agency, namely the attorney general. In the remaining states the registration or report is filed with the probate court.

Fifth, the enforcing authority is granted the power to investigate transactions and relationships of trustees and to require persons to give information and produce materials. Eleven states have statutes conferring subpoena-type powers on the enforcing authority. For example, the New Hampshire statute provides:

> For the purposes of such investigation the attorney-general may require any (listed entity) to appear at the state house at such time and place as the attorney-general may designate then and there under oath to produce for the use of the attorney-general any and all books, memoranda, papers of whatever kind, documents of title or other evidence of assets or liabilities which may be in the ownership or possession or control of such (listed person) and to furnish such other available information relating to said trust as the attorney-general may require. N.H. Rev. Stat. Ann. §7-24 (1955).

Sixth, the more comprehensive charitable trust statutes will place rule-making powers in the hands of the enforcement agency. For the most part, however, rule making is limited to those situations where information is necessary to complete registration. Michigan, California, and Illinois are the only states in which the enforcement authority is given general rule-making power over all phases of the regulation of charitable trusts and foundations. Two California statutes typify both types of rule-making capabilities:

> The Attorney General shall make rules and regulations as to the time for filing reports, the contents thereof, and the manner of executing and filing them. Cal. Govt. Code §12586(b).
>
> The Attorney General may make additional rules and regulations necessary for the administration of this article. Cal. Govt. §12587.

Seventh, some statutes require the probate judge to notify the enforcing authority whenever a will containing a charitable bequest is admitted to probate. Nine state statutes have such a provision. In Ohio the statute provides: "Immediately after the probate of any will containing clauses creating or purporting to create a charitable trust as defined in section 109.23, the probate judge shall notify the attorney general thereof." Ohio Rev. Code §109.30 (1953).

The accompanying charts analyze by state the basic legislative enactments listed above. The charts do not reflect common law powers which have developed through case law of the respective states.

Table 1

Attorneys General Enforcement Authority: Statutory Basis for Regulation of Charitable Trusts and Foundations (as of August 1974)

Alabama	None
Alaska	ALASKA STAT. sec. 10.20 (1962), ALASKA STAT. sec. 9.25.010 (1962)
Arizona	ARIZ. REV. STAT. ANN. sec. 14-642 (Supp. 1964)
Arkansas	None
California	CAL. GOVT. CODE, sec. 12580 et seq. (1959)
Colorado	COLO. REV. STAT. ANN. art. 57-10 (1963), COLO. REV. STAT. ANN. sec. 135-1-1 (1963)
Connecticut	CONN. GEN. STAT. sec. 3-125
Delaware	None
Florida	FLA. STAT. ANN. sec. 737.251
Georgia	GA. CODE ANN. sec. 108-212 (1962) amended (1974)
Hawaii	HAWAII REV. LAW ch. 554 (1955)
Idaho	IDAHO CODE ANN. sec. 67-1401 (Supp. 1963)
Illinois	ILL. REV. STAT. ch. 14, sec. 51, et seq. (1961)
Indiana	IND. ANN. STAT. sec. 31-712
Iowa	IOWA CODE ANN. ch. 303, sec. 633 (1973)
Kansas	None
Kentucky	KY. REV. STAT. sec. 15.020, 273.323, 273.400
Louisiana	LA. REV. STAT. 9:2271 et seq. (1971)
Maine	ME. REV. STAT. ANN. tit. 5, sec. 194 (1964)
Maryland	MD. ANN. CODE art. 41, sec. 103A-103C (1964); art. 16 & [illegible] (1957)
Massachusetts	MASS. GEN. LAWS ANN. ch. 12, sec. 8
Michigan	MICH. STAT. ANN. sec. 14.251 (1961) & 26.1200(1) et seq. (1961)
Minnesota	MINN. STAT. sec. 501.12 (1945); MINN. STAT. sec. 317.01 et seq. (1951)
Mississippi	MISS. CODE ANN. 91-9-409 (1972)
Missouri	MO. STAT. ANN. sec. 456.225(4) (Supp. 1964)
Montana	None
Nebraska	NEB. REV. STAT. sec. 24-612 (1951)
Nevada	NEV. REV. STAT. sec. 165.230 (1967)
New Hampshire	N.H. REV. STAT. ANN. sec. 7:19-7:32-a (1943); Act of 1971 amt'd
New Jersey	N.J. STAT. ANN. sec. 3A:43-7 (1971)
New Mexico	N.M. STAT. ANN. sec. 33-2-22, 33-3-12(2) (1953)
New York	Est., Powers & Trusts ch. 831, sec. 8-1.4 (1966)
North Carolina	N.C. GEN. STAT. art. IV, ch. 36 (1971)
North Dakota	N.D. CENT. CODE sec. 50-04-02 et seq.
Ohio	OHIO REV. CODE ANN. sec. 109.23 et seq., amended 1971
Oklahoma	OKLA. STAT. ANN. TIT. 60 sec. 175.18
Oregon	ORE. REV. STAT. sec. 128.610-128.750; sec. 128.805-128.870, sec. 128.990
Pennsylvania	PA. STAT. TIT. 20 sec. 301.10
Rhode Island	R.I. GEN. LAWS ANN. 18-9-1 (1950)
South Carolina	S.C. CODE ANN. sec. 1-240, 67-85 (1962)
South Dakota	S.D. CODE sec. 59.0603 (Supp. 1960)
Tennessee	TENN. CODE Ann. sec. 23-2802 (1956)
Texas	TEX. ANN. CIV. STAT. art. 4412(a)
Utah	None
Vermont	VT. STAT. ANN. tit. 14, sec. 2501-2503 (1959)
Virginia	VA. CODE ANN. sec. 55-29 (1950)
Washington	WASH. REV. CODE ANN. tit. 19, ch. 10 (1967)
West Virginia	None
Wisconsin	WIS. STAT. ch. 701
Wyoming	WYO. STAT. ANN. sec. 4-46 (1957) as amended (1973)

Table 2

Comparative Analysis of State Charitable Trust Statutes
(As of August 1974)

	Alabama	Alaska	Arizona	Arkansas	California
Is the AG the enforcing authority	No	No	No	Ark. Stat. Ann. sec. 12-725 (1957)	Cal. Govt. Code sec. 12581 (1959)
Is the AG a necessary party	No	No	No	No	Cal. Govt. Code sec. 12591 (1959)
Does the AG have the authority to institute actions to enforce charitable trusts	No	No	No	No	Cal. Govt. Code sec. 12591 (1959)
Is registration required	No	No	No	No	Cal. Govt. Code sec. 12585 (1959)
Are periodic reports required	No	No	No	No	Cal. Govt. Code sec. 12586 (1959)
Does the enforcing authority have subpoena power	No	No	No	No	Cal. Govt. Code sec. 12588 (1959)
Rule-making authority	No	No	No	No	Cal. Govt. Code sec. 12587 (1959)
Probate judge to notify enforcing authority	No	No	No	No	Cal. Govt. Code sec. 12593 (1959)

Table 2 (Continued)

	Colorado	Connecticut	Delaware	Florida	Georgia
Is the AG the enforcing authority	Colo. Rev. Stat. Ann. art. 57-10-5 (1971)	Conn. Gen. Stat. Ann. sec. 3-125 (1958)	No	No	Ga. Code Ann. sec. 108-212 (1962)
Is the AG a necessary party	No	No	No	No	Ga. Code Ann. sec. 108-227 (1974)
Does the AG have the authority to institute actions to enforce charitable trusts	No	Conn. Gen. Stat. Ann. sec. 3-125 (1958)	No	No	Ga. Code Ann. sec. 108-212 (1962)
Is registration required	No	No	No	No	Ga. Code Ann. sec. 108-221 (1974)
Are periodic reports required	Colo. Rev. Stat. Ann. art. 153-14-11 (1963)*	Conn. Gen. Stat. Ann. sec. 45-267 (1963)*	Del. Code Ann. tit. 12 sec. 3521 (1958)*	Fla. Stat. Ann. sec. 737.12 (1959)*	Ga. Code Ann. sec. 108-233 (1974)
Does the enforcing authority have subpoena power	No	No	No	No	Ga. Code Ann. sec. 108-234 (1974)
Rule-making authority	No	No	No	No	Ga. Code Ann. sec. 108-233 (1974)
Probate judge to notify enforcing authority	No	No	No	No	No

Table 2 (Continued)

	Hawaii	Idaho	Illinois	Indiana	Iowa
Is the AG the enforcing authority	Haw. Rev. Stat. secs. 554-6 (1968), 554-10 (1971)	Idaho Code Ann. sec. 67-1401 (Supp. 1963)	Ill. Ann. Stat. ch. 14 sec 51 et seq. (1961)	Ind. Stat. Ann. sec. 30-4-5-12 (1971)	Iowa Code Ann. sec. 633.303 (1965)
Is the AG a necessary party	No	No	Ill. Ann. Stat. ch. 14 sec. 57 (1961)	No	No
Does the AG have the authority to institute actions to enforce charitable trusts	No	Idaho Code Ann. sec. 67-1401 (Supp. 1963)	Ill. Ann. Stat. ch. 14 sec. 62 (1961)	No	Iowa Code Ann. sec. 633.303 (1965)
Is registration required	No	Idaho Code Ann. sec. 15-7-101 (1971)*	Ill. Ann. Stat. ch. 14 sec. 56 (1961)	No	No
Are periodic reports required	Haw. Rev. Stat. sec. 554-4 (1968)*	No	Ill. Ann. Stat. ch. 14 sec. 57 (1961)	Ind. Stat. Ann. sec. 30-4-5-12 (1971)*	Iowa Code Ann. sec. 633.700 (1962)*
Does the enforcing authority have subpoena power	No	No	Ill. Ann. Stat. ch. 14 sec. 59 (1961)	No	No
Rule-making authority	No	No	Ill. Ann. Stat. ch. 14 sec. 58 (1961)	No	No
Probate judge to notify enforcing authority	No	No	No	No	Iowa Code Ann. sec. 633.303 (1965)

Table 2 (Continued)

	Kansas	Kentucky	Louisiana	Maine	Maryland
Is the AG the enforcing authority	No	Ky. Rev. Stat. sec. 15.020 (1944)	No	Me. Rev. Stat. Ann. tit. 5 sec. 194 (1954)	Md. Ann. Code art. 16 sec. 195 (1957)
Is the AG a necessary party	No	No	No	No	No
Does the AG have the authority to institute actions to enforce charitable trusts	No	Ky. Rev. Stat. sec. 15.020 (1944)	No	Me. Rev. Stat. Ann. tit. 5 sec. 194 (1954)	Md. Ann. Code art. 16 sec. 195 (1957)
Is registration required	No	No	No	No	No
Are periodic reports required	No	Ky. Rev. Stat. sec. 25.175*	No	Me. Rev. Stat. Ann. tit. 18, sec. 4001 (1954)*	No
Does the enforcing authority have subpoena power	No	No	No	No	No
Rule-making authority	No	No	No	No	No
Probate judge to notify enforcing authority	Kan. Stat. Ann. sec. 59-2222 (1963)	No	No	No	No

Table 2 (Continued)

	Massachusetts	Michigan	Minnesota	Mississippi	Missouri
Is the AG the enforcing authority	Ann. Laws of Mass. ch. 12 sec 8	Mich. Stat. Ann. sec. 26.1200(1966)	Minn. Stat. Ann. sec. 501.12 (1945)	Miss. Code Ann. 91-9-409 (1972)	Mo. Stat. Ann. sec. 456.225 (1971)
Is the AG a necessary party	Ann. Laws of Mass. ch. 12 sec. 8G	Mich. Stat. Ann. sec. 26.1200(4) (1966)	No	No	No
Does the AG have the authority to institute actions to enforce charitable trusts	Ann. Laws of Mass. ch. 12 sec. 8	Mich. Stat. Ann. sec. 26.100(4) (1966)	Minn. Stat. Ann. sec. 501.12 (1945)	No	No
Is registration required	Ann. Laws of Mass. ch. 12 sec. 8E	Mich. Stat. Ann. sec. 26.1200(5) (1966)	No	No	No
Are periodic reports required	Ann. Laws of Mass. ch. 12 sec. 8F	Mich. Stat. Ann. sec. 26.1200(5) (1966)*	Minn. Stat. Ann. sec. 501.34 (1945)*	No	Mo. Stat. Ann. sec. 456.220 (1939)*
Does the enforcing authority have subpoena power	Ann. Laws of Mass. ch. 12 sec. 8H	Mich. Stat. Ann. sec. 26.1200(9) (1966)	No	No	No
Rule-making authority	Ann. Laws of Mass. ch. 12 sec. 8I	Mich. Stat. Ann. sec. 26.1200(4) (1966)	No	No	No
Probate judge to notify enforcing authority	No	No	No	No	No

Table 2 (Continued)

	Montana	Nebraska	Nevada	New Hampshire	New Jersey
Is the AG the enforcing authority	No	Nebr. Rev. Stat. sec. 24-612 (1951)	Nev. Rev. Stat. sec. 165.23 (1967)	N.H. Rev. Stat. Ann. sec. 7:19 (1955)	N.J. Stat. Ann. sec. 2A:43-7 (1971)
Is the AG a necessary party	No	No	No	N.H. Rev. Stat. Ann. sec. 7:19 (1955)	No
Does the AG have the authority to institute actions to enforce charitable trusts	No	No	No	N.H. Rev. Stat. Ann. sec. 7:20 (1955)	No
Is registration required	No	No	No	N.H. Rev. Stat. Ann. sec. 7:19 (1955)	No
Are periodic reports required	No	No	Nev. Rev. Stat. sec. 165.040 (1967)*	N.H. Rev. Stat. Ann. sec. 7:28 (1955)	N.J. Stat. Ann. sec. 3A:9-3 (1953)*
Does the enforcing authority have subpoena power	No	No	No	N.H. Rev. Stat. Ann. sec. 7:24 (1955)	No
Rule-making authority	No	No	No	N.H. Rev. Stat. Ann. sec. 7:22 (1955)	No
Probate judge to notify enforcing authority	No	No	No	N.H. Rev. Stat. Ann. sec. 7:29 (1955)	No

Table 2 (Continued)

	New Mexico	New York	North Carolina	North Dakota	Ohio
Is the AG the enforcing authority	N. Mex. Stat. 1953 sec. 33-2-22 (1953)	N.Y. EPTL sec. 8-1.1 (1966)	Gen. Stat. of N. Car. sec. 36-20 (1971)	N.D. Cent. Code sec. 59-04-02 (1960)	Ohio Rev. Code Ann. sec. 109.24 (1953)
Is the AG a necessary party	No	N.Y. EPTL sec. 8-1.4 (1966)	No	No	Ohio Rev. Code Ann. sec. 109.25 (1953)
Does the AG have the authority to institute actions to enforce charitable trusts	No	N.Y. EPTL sec. 8-1.1 (1966)	Gen. Stat. of N. Car. sec. 36-20 (1971)	N.D. Cent. Code sec. 59-04-02 (1960)	Ohio Rev. Code Ann. sec. 109.24 (1953)
Is registration required		N.Y. EPTL sec. 8-1.4 (1966)	No	No	Ohio Rev. Code Ann. sec. 109.27 (1953)
Are periodic reports required	N. Mex. Stat. 1953 sec. 33-2-3 (1953)[a]	N.Y. EPTL sec. 8-1.4 (1966)	Gen. Stat. of N. Car. sec. 36-19[a] (1971)	No	Ohio Rev. Code Ann. sec. 109.31 (1953)
Does the enforcing authority have subpoena power	No	N.Y. EPTL sec. 8-1.4 (1966)	No	No	No
Rule-making authority	No	N.Y. EPTL sec. 8-1.4 (1966)	No	No	Ohio Rev. Code Ann. sec. 109.27 (1953)
Probate judge to notify enforcing authority	No	No	No	No	Ohio Rev. Code Ann. sec. 109.30 (1953)

Table 2 (Continued)

	Oklahoma	Oregon	Pennsylvania	Rhode Island	South Carolina
Is the AG the enforcing authority	No	Ore. Rev. Stat. sec. 128.710 (1963)	Pa. Stat. Ann. tit. 20 sec. 6110 (1972)	R.I. Gen. Laws Ann. sec. 18-9-1 (1956)	S.C. Code Ann. sec. 1-240 (1962)
Is the AG a necessary party	No	No	No	R.I. Gen. Laws Ann. sec. 18-9-5 (1956)	No
Does the AG have the authority to institute actions to enforce charitable trusts	No	Ore. Rev. Stat. sec. 128.710 (1963)	Pa. Stat. Ann. tit. 20 sec. 6110 (1972)	R.I. Gen. Laws Ann. sec. 18-9-6 (1956)	S.C. Code Ann. sec. 1-240 (1962)
Is registration required	No	Ore. Rev. Stat. sec. 128.660 (1963)	No	R.I. Gen. Laws Ann. sec. 18-9-6 (1956)	S.C. Code Ann. sec. 67-81 (1962)
Are periodic reports required	No	Ore. Rev. Stat. sec. 128.670 (1963)	No	R.I. Gen. Laws Ann. sec. 18-9-13 (1956)	S.C. Code Ann. sec. 67-82 (1962)
Does the enforcing authority have subpoena power	Okla. Constitution Art. IV sec. 28	Ore. Rev. Stat. sec. 128.680 (1963)	No	R.I. Gen. Laws Ann. sec. 18-9-9 (1956)	No
Rule-making authority	No	Ore. Rev. Stat. sec. 128.670 (1963)	No	R.I. Gen. Laws Ann. sec. 18-9-8 (1956)	S.C. Code Ann. sec. 67-84 (1962)
Probate judge to notify enforcing authority	No	Ore. Rev. Stat. sec. 128.720 (1963)	No	R.I. Gen. Laws Ann. sec. 18-9-5 (1956)	No

Table 2 (Continued)

	South Dakota	Tennessee	Texas	Utah	Vermont
Is the AG the enforcing authority	S.D. Compiled Laws Ann. sec. 55-9-5-(Supp. 1960)	Tenn. Code Ann. sec. 23-2802 (1956)	Tex. Ann. Civ. Stat. art. 4412a (1972)	No	Vt. Stat. Ann. tit. 14 sec. 2502 (1959)
Is the AG a necessary party	No	No	Tex. Ann. Civ. Stat. art. 4412a (1972)	No	No
Does the AG have the authority to institute actions to enforce charitable trusts	S.D. Compiled Laws Ann. sec. 55-9-5-(Supp. 1960)	Tenn. Code Ann. sec. 23-2802 (1956)	Tex. Ann. Civ. Stat. art. 4412a (1972)	No	No
Is registration required	No	No	No	No	No
Are periodic reports required	S.D. Compiled Laws Ann. sec. 21-22-14 (Supp. 1960)*	No	No	Utah Code Ann. sec. 75-12-30*	Vt. Stat. Ann. tit. 14 sec. 2501 (1959)*
Does the enforcing authority have subpoena power	No	No	No	No	No
Rule-making authority	No	No	No	No	No
Probate judge to notify enforcing authority	No	No	No	No	No

Table 2 (Continued)

	Virginia	Washington	West Virginia	Wisconsin	Wyoming
Is the AG the enforcing authority	Va. Code Ann. sec. 55-29 (1950)	Wash. Rev. Code Ann. sec. 19.10.120 (1967)	No	Wis. Stat. Ann. sec. 701.10	Wyo. Stat. Ann. sec. 4-46 (1973)
Is the AG a necessary party	No	Wash. Rev. Code Ann. sec. 19.10.120 (1967)	No	Wis. Stat. Ann. sec. 701.10	No
Does the AG have the authority to institute actions to enforce charitable trusts	Va. Code Ann. sec. 55-29 (1950)	Wash. Rev. Code Ann. sec. 19.10.130 (1967)	No	Wis. Stat. Ann. sec. 701.10	No
Is registration required	Va. Code sec. 57-48 (1974)	Wash. Rev. Code Ann. sec. 19.10.050 (1967)	No	No	No
Are periodic reports required	Va. Code Ann. sec. 55-29 (1950)	Wash. Rev. Code Ann. sec. 19.10.070 (1967)	W. Va. Code secs. 44-4-4, 44-4-6*	Wis. Stat. Ann. sec. 701.16 (4)*	No
Does the enforcing authority have subpoena power	No	Wash. Rev. Code Ann. sec. 19.10.100 (1967)	No	No	No
Rule-making authority	No	Wash. Rev. Code Ann. sec. 19.10.070 (1967)	No	No	No
Probate judge to notify enforcing authority	No	Wash. Rev. Code Ann. sec. 19.10.080 (1967)	No	Wis. Stat. Ann. sec. 879.03	No

*Annual report filed with the probate court by testamentary trustees only.

The Office of the Attorney General

Despite the existence of statutory or common law authority which provides for the regulation of charitable trusts and foundations, there are numerous additional factors which have a bearing upon the scope and extent to which that authority is exercised. In particular, the strength of any statutory or common law authority vested in the attorney general is dependent upon the existence of a fully operative staff.

In order to examine this aspect of the regulation of charitable trusts and foundations, a questionnaire was prepared by staff members in the Charitable Foundations Section of the Ohio Attorney General's Office and sent to the office of each attorney general throughout the United States. Because it was thought that reponses to certain questions could be better expressed verbally rather than as short written answers, a follow-up telephone call was made. The questionnaire was divided into two major parts: the first concerned charitable trusts and foundations, the second dealt with charitable solicitations. The information to be gathered by the questionnaire was similar to that obtained by the Committee on the Office of the Attorney General (C.O.A.G.) and the Ohio Attorney General in their study of the same topic during the fall of 1973. The information compiled by this more recent questionnaire updated and expanded the scope of the earlier C.O.A.G. study.

The questionnaire was primarily directed toward issues relating to the office function of any state agency regulating charitable trusts and foundations. Specific questions were directed toward the size and composition of the staff, the existence and utilization of registration and reporting requirements imposed by state law, enforcement and the feasibility of uniform legislation. The mere recognition of the attorney general's office as the chief enforcement agency, however, does not necessarily indicate that supervision is in fact exercised. (See Table 3.) An examination of the size of the staff within each attorney general's office provides further indicia of the extent to which the attorney general is actively engaged in the supervision of charitable entities, regardless of the existence of common law or statutory authority. Table 4 indicates staff size on a full- and part-time basis.

Of the 46 states responding to both questionnaries, 36 report that there is at least one attorney who is assigned the responsibility of regulating charitable entities on either a full- or part-time basis. Eleven states including California, Colorado, Illinois, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania, Texas, and Washington report having an attorney assigned on a full-time basis. A total of 11 states report that there are no individuals within the attorney general's office assigned to the area of charitable trusts and foundations. These states are Alaska, Arizona, Arkansas, Louisiana, Mississippi, Nebraska, Oklahoma, South Dakota, Tennessee, Vermont, and Wyoming. With the exception of Alaska, Arizona, Louisiana, and Vermont, however, all recognize the existence of some regulatory authority vested in the office of the attorney general.

In addition to the presence of attorneys in this area, seven states report employing accountants who review various reporting and registration forms which are required to be filed. California, Illinois, New York, Ohio, Michigan, and Utah indicated the assignment of accountants on a full-time basis while Colorado reported the use of an accountant on a part-time basis. Apart from accountants, there are additional supportive personnel including investigators, registrars, and law clerks.

Table 5 indicates the number of charitable trusts and foundations located in each state and the dollar amount of their assets. Responses to this question may well have been the most difficult because in the absence of reporting or registration requirements it is virtually impossible to provide an accurate figure, or any figure at all. Even with the existence of these requirements, all states, with the exception of California and Rhode Island (which utilize data processing equipment), must rely on manual tallies.

Table 3

Agencies Regulating Charitable Trusts and Foundations (As of August 1974)

	Attorney General	Other Agency
Alabama		
Alaska	No	Yes (Department of Commerce)
Arizona	No	No
Arkansas	Yes	No
California	Yes	No
Colorado	Yes	Yes (Secretary of State, Department of Revenue)
Connecticut		
Delaware	Yes	No
Florida		
Georgia	Yes	No
Hawaii	Yes	No
Idaho	Yes	No
Illinois	Yes	No
Indiana	Yes	No
Iowa	Yes	No
Kansas	Yes	No
Kentucky	Yes	No
Louisiana	No	No (Beneficiaries may file)
Maine	Yes	No
Maryland	Yes	Yes (Secretary of State)
Massachusetts	Yes	No
Michigan	Yes	No
Minnesota	Yes	No
Mississippi	Yes	No
Missouri	Yes	No
Montana		
Nebraska	Yes	No
Nevada	Yes	No
New Hampshire	Yes	No
New Jersey	Yes	No
New Mexico	Yes	No
New York	Yes	No
North Carolina	Yes	No
North Dakota	Yes	No
Ohio	Yes	No
Oklahoma	Yes	Yes (Commissioner of Charities and Corrections)
Oregon	Yes	No
Pennsylvania	Yes	No
Rhode Island	Yes	No
South Carolina	Yes	No
South Dakota	Yes	No
Tennessee	Yes	No
Texas	Yes	No
Utah	Yes	No
Vermont	No	No
Virginia	Yes	No
Washington	Yes	No
West Virginia	Yes	No
Wisconsin	Yes	No
Wyoming	Yes	No

The survey indicated that the largest number of charitable trusts were located in New York (18,100). The lowest number (10) were found in North Dakota. The total amount of assets held by charitable trusts and foundations in any one jurisdiction ranges from an estimated high of $9 million in California to a low of $300,000 in South Dakota.[25]

Table 4

Number of Personnel in the Attorney General's Office Assigned to Charitable Trusts and Foundations (As of August 1974)

	Attorneys	Accountants	Other
Alabama			
Alaska	None	None	None
Arizona	None	None	None
Arkansas	None	None	None
California	8 FT	10 FT	2 FT Registrars
Colorado	1 FT; 3 PT	1 PT	2 Independent
Connecticut		Accountants hired for 1 case	
Delaware	1 PT	None	None
Florida			
Georgia	2 PT		
Hawaii	1 PT		
Idaho	2 PT		
Illinois	6 FT	2 FT	3 FT Special Asst. Attorneys General
Indiana	2 PT		
Iowa	1 PT		
Kansas	1 PT		
Kentucky	1 PT		
Louisiana	None	None	None
Maine	3 PT	None	
Maryland	1 PT	None	1 law clerk
Massachusetts	4 FT	None	2 law clerks
Michigan	6 FT; 2 PT	1 PT	3 PT investigators
Minnesota	2 PT		
Mississippi	None		
Missouri	4 PT		
Montana			
Nebraska	None	None	None
Nevada	1 PT	None	None
New Hampshire	1 PT	None	1 PT Registrar
New Jersey	1 FT	None	
New Mexico	1 PT	None	
New York	10 FT	6 FT	
North Carolina	1 PT		
N. Dakota	1 PT		
Ohio	10 FT	3 FT	3 legal aides; 2 FT invest.
Oklahoma	None	None	None
Oregon	1 PT		1 PT Registrar
Pennsylvania	3 FT		
Rhode Island	1 PT		
South Carolina	1 PT		
South Dakota	None specifically assigned		
Tennessee	None	None	None
Texas	2 FT		1 PT law clerk
Utah	1 PT	1 FT	
Vermont	None	None	None
Virginia	2 PT		
Washington	2 FT		
West Virginia	1 PT		
Wisconsin	1 PT		
Wyoming	None		

Note: FT = Full-time; PT = Part-time.

The combined surveys indicate that a total of 34 states impose reporting or registration requirements. Table 6 which illustrates only the results of the Ohio Attorney General's survey, indicates that 13 states impose some form of registration requirement upon charitable trusts and foundations where that registration is filed with the attorney general: California, Georgia, Illinois, Massachusetts, Michigan, New

Table 5

Estimated Number of Charitable Trusts and Their Values
(As of August 1974)

	Number of Trusts	Total Assets
Alabama		
Alaska	Unknown	Unknown
Arizona	65	$531,000,000
Arkansas		
California	14,000	$7-9,000,000,000
Colorado	2,000	Unknown
Connecticut		
Delaware	Unknown	Unknown
Florida		
Georgia	Unknown	Unknown
Hawaii	80	$500,000
Idaho	55-60	Unknown
Illinois	7,295	$2,000,000,000
Indiana	1,600	$1,500,000,000
Iowa	300-400	$70,000,000
Kansas	300	$70,000,000
Kentucky	2,000	Unknown
Louisiana		
Maine	249	$38,000,000
Maryland	359	$160,000,000*
Massachusetts		
Michigan	5,000	$4,000,000,000
Minnesota	Information unavailable	Information unavailable
Mississippi	Unknown	Unknown
Missouri	616	Unknown
Montana		
Nebraska	Unknown	Unknown
Nevada	Unknown	Unknown
New Hampshire	1,000	$125,000,000
New Jersey	Unknown	Unknown
New Mexico	40	$17,000,000
New York	18,100	Unknown
North Carolina	150	Unknown
North Dakota	10	$1,000,000
Ohio	4,200	$2,000,000,000
Oklahoma	Unknown	Unknown
Oregon	1,000	$200,000,000
Pennsylvania	2,000	Unknown
Rhode Island	650	$350,000,000
South Carolina	187	Unknown
South Dakota	50	$300,000
Tennessee	Unknown	Unknown
Texas	1,300	$1,333,000,000
Utah	Unknown	Unknown
Vermont	Unknown	Unknown
Virgin Islands	Unknown	Unknown
Virginia	Unknown	Unknown
Washington	497	$191,000,000
West Virginia	Unknown	Unknown
Wisconsin	Unknown	Unknown
Wyoming	Unknown	Unknown

*Does not include Sloan Foundation.
See also report to the Commission on Private Philanthropy and Public Needs from the Council on Foundations, Inc.

Hampshire, New York, Ohio, Oregon, Rhode Island, South Carolina, Virginia, and Washington. Many states require, particularly in the case of testamentary dispositions, that a periodic report be filed solely with the probate court. Other states require that the periodic report, whether it refers to a testamentary

Table 6

States That Impose Registration or Reporting Requirements on Charitable Trusts and Foundations with the Attorney General
(As of August 1974)

	Registration Statement	Periodic Reporting
Alabama		
Alaska	No	No
Arizona	No	No
Arkansas	No	No
California	Yes	Yes
Colorado		
Connecticut		
Delaware	No	No
Florida		
Georgia	Yes	Yes
Hawaii	No	No
Idaho	No	No
Illinois	Yes	Yes
Indiana	No	No
Iowa	No	No
Kansas	No	No
Kentucky	No	No
Louisiana		
Maine	No	No
Maryland	No	No
Massachusetts	Yes	Yes
Michigan	Yes	Yes
Minnesota	No	No
Mississippi	No	No
Missouri	No	No
Montana		
Nebraska	No	No
Nevada	No	No
New Hampshire	Yes	Yes
New Jersey		
New Mexico		
New York	Yes	Yes
North Carolina	No	No
North Dakota	No	No
Ohio	Yes	Yes
Oklahoma		
Oregon	Yes	Yes
Pennsylvania	No	No
Rhode Island	Yes	Yes
South Carolina	Yes	Yes
Tennessee	No	No
Texas	No	No
Utah		
Vermont		
Virginia	Yes	Yes
Washington	Yes	Yes
West Virginia		
Wisconsin	No	No
Wyoming	No	No

disposition or not, be filed with the attorney general. It is entirely possible therefore that a periodic report in some states will be filed with both the attorney general and the probate court. It should be remembered that a number of these states indicate that the Internal Revenue Service forms will satisfy the state reporting requirements. It is suggested that more states follow such a practice. Not only does it decrease administrative costs to the foundation, but it also promotes uniformity.

It would appear that registration and reporting requirements form the cornerstone of an effective ongoing enforcement process. The most important aspect of these statements, from a regulatory viewpoint, is to inform the attorney general's office of the existence of a charitable entity within his jurisdiction and to provide fundamental information regarding its operation.

The particular information sought by a registration statement varies from state to state. In large measure, however, all of these forms call for the name and address of the organization and the names of all officers, directors, or trustees. In addition, the usual form requires information regarding the purpose of the organization and a listing of all its assets and specific charitable beneficiaries. The forms used for registration purposes are generally standardized, and they are filed with the attorney general's office directly, or where appropriate, with the probate court. Where the instrument is a will, it is not uncommon to find a stipulation that it be attached to the registration form.

The most important documents filed with the attorney general, at least in terms of regulation, are the periodic reporting forms. They contain financial information relating to income and expense and form the basis for determining the extent of compliance with the trust instrument or foundation charter. Where the attorney general conducts a vigorous audit of these reports, a number of irregularities appear. (See page 2736 for a discussion of types of abuses in the administration of charitable trusts and foundations.)

In order to ascertain the extent to which there is active enforcement of the regulatory authority concerning charitable trusts and foundations, each attorney general's office contacted was asked to provide information regarding the amount of litigation that had been engaged in and the number of settlement negotiations participated in by the office staff. (Records concerning the number of settlement negotiations were not tabulated in any state.) The purpose of the question was to differentiate between those offices which merely perform a filing or registration function and those which are actively engaged in the enforcement of a regulatory scheme.

Of the 38 states responding to the Ohio Attorney General's questionnaire, 22 reported participation in formal litigation: California, Delaware, Hawaii, Idaho, Indiana, Iowa, Kansas, Maine, Massachusetts, Michigan, Minnesota, Missouri, New Hampshire, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, Texas, Virginia, and Washington. These figures represent not only cases which have been brought by the attorney general, but also those in which the attorney general was by law a necessary party.

While the above data may be indicative of an active enforcement program, they should not be interpreted to mean that those agencies which record a small amount of litigation are not actively engaged in the regulation of charitable trusts. As was indicated earlier, auditing of financial reports plays a large role in the enforcement picture. If a problem can be worked out by a routine audit without resort to expensive litigation or protracted conferences, it benefits all concerned.

Surprisingly, the attorney general is not the exclusive authority for the enforcement of charitable trusts and foundations. Six states indicated that there is some local enforcement authority. These states are California, Georgia, Mississippi, North Dakota, Ohio, and Virginia. Since no records are maintained on the amount of activity of these local units, it is impossible to ascertain the extent of their regulatory activities.

In addition to the purely regulatory functions performed by the attorney general's office, there are public service benefits to be derived. The office of the attorney general acts as a clearinghouse for charitable foundation information. A registry of charitable trusts and foundations is in effect a library of source material for persons or entities seeking funding.

The survey indicated that all states that have reporting requirements provide for public inspection of the files. In those states where Internal Revenue Service Form 990s are kept on file, there is some variance of opinion as to whether that information should be made available to the public. A majority of states provide for public inspection of the 990 series. It is suggested that any policy which prevents the public from inspecting these forms is indefensible. Neither the Internal Revenue Code or state law prohibit such inspections. A number of states including California, New Hampshire, Ohio, Oregon, Pennsylvania, Rhode Island, and Washington have a standard procedure for making the stored information available to the public. This procedure may consist of either a published directory or a computer printout.

Although there is a definite trend toward increased enforcement, there are a number of reasons why individual attorneys general are not active in the regulation of charitable trusts. Among these are the absence of an adequate staff, weak or nonexistent statutory authority, or a bureaucratic structure which requires filing in one office and enforcement in another. In addition, the small number of charitable trusts and foundations in certain jurisdictions makes it highly impractical to enact either an elaborate statutory scheme or to maintain an extensive staff.

But assuming any level of charitable trust regulation, the threshold question seems to be, In what *manner* should the attorney general exercise his supervisory powers? It seems clear that the relationship between a government agency organized to regulate charitable foundations and the foundation community does not fit the typical mold found in government-private entity regulation. The governing authority is certainly not a tool of the foundations, nor is it one that casts a shadow over every foundation activity. A delicate balance exists which is sometimes difficult to measure. It may often be exhibited by a lack of bureaucracy and a recognition that both government and foundations have as their overriding concern the ultimate benefit of the public. The procedural aspect of charitable foundation regulation is more of an attitude of understanding rather than adherence to a strict set of bureaucratic rules. Nothing tends to polarize feelings more than a government policy which has no built-in flexibility. Therefore, the use of a tax as a method of charitable trust enforcement is clearly inappropriate. There are many other ways to correct abuses and accomplish the purposes of the trust without resort to such punitive measures.[26]

On the federal level, it has been suggested[27] that it could be accomplished by an agency or center created solely for the supervision of charitable trusts and having the following characteristics and functions:

1. The center should be concerned only with the field of charity and not with other forms of tax-exempt organizations.

2. The center should rest on the assumption that charity exists for the benefit of the community, and the public interest is as much served by it as by governmental action. The essential purpose of supervision, therefore, is affirmative – to protect, strengthen, and encourage charity and build public confidence in it. Sanctions applied to prevent abuse should, it follows, be designed so as not to deplete charity itself, as this would by definition be contrary to the public interest.

3. The center should recognize that the States have many basic powers and responsibilities in regard to charity. Therefore, it should be the center's duty to develop means to cooperate with State authorities in furtherance of joint Federal and State objectives.

4. The center should be nonpartisan, objective, fair-minded, and independent in its operations.

5. The center should be manned both at policy and staff levels by well-trained individuals with the necessary educational background and experience to deal competently with the needs and problems of the charitable field.

A supervisory center with these broad characteristics would perform a number of important functions. The principal ones are as follows:

1. The center would have the power to determine what is charitable and to grant or deny tax exemption accordingly, although this power might be limited by a right of appeal to the courts.

2. The center would maintain a publicly available register. Listing in this register would be an organization's guarantee that it enjoyed tax-exempt, charitable status.

3. The center would conduct audits of the operations of tax-exempt, charitable organizations.

4. The center would have the duty to see to it that the legal standards applying to charity were enforced.

5. The center would, when requested, give advisory opinions with respect to the legal consequences of proposed actions by charitable organizations.

6. The center would gather data about all aspects of charity, would issue publications periodically, and would provide information to the public on request.

While these recommendations are idealistic, they reflect the kinds of activities that are presently and successfully carried on by some state agencies. It should also be noted that with proper leadership, the above characteristics could be adopted by the Internal Revenue Service. While it may mean that certain long-established bureaucratic practices (whose only basis for existence is time) would be abolished, the end result would certainly be worth the effort.

From this survey it seems clear that there is a growing trend among the states to regulate charitable trusts and foundations. What form this regulation is to take depends very much on the attitudes of the regulatory agency. It is hoped that it will be recognized that a large bureaucracy and an inflexible administration is not the answer.

Federal-State Relationships

Reporting Requirements

In anticipation of the states' greater role in the regulation of charitable organizations and to facilitate effective state enforcement, Congress provided state officials with various avenues of access to information relating to public and private foundations. Under current law, all 501(c)(3) organizations, with few exceptions,[28] are required to file annual financial reports with the federal government. These reporting requirements are found in §§6033, 6034, and 6056 of the Internal Revenue Code of 1954 (hereinafter referred to as the IRC). However, only the reports of private foundations, Form 990 PF, supporting forms, and schedules, are required to be sent directly to state officials.[29] Although there is a mechanism to provide the state with copies of exemption applications and public foundation reports (Form 990), they are not as readily available as the material on private foundations.[30] As a result, an anomalous situation exists; private foundation reports are now public but public foundation reports are private.[31] One could presume that the rationale for the repeal of §503(b) of the IRC (listing certain prohibited transactions by public foundations) by the Tax Reform Act of 1969 was that public foundations are by their very nature constantly under the public's watchful eye. The need to have the same reporting rules that are applicable to private foundations (vis a vis the states) are unnecessary. The basic premise of that argument, however, is not valid. The repeal by Congress of prohibitions on public foundations should not imply that problems such as lending without security, paying excessive compensation, self-dealing, and so on, do not exist among such organizations.

Additionally, an assumption that the public is capable of exposing these abuses because the foundations are in the "public" domain is also fallacious. The real effect of repealing those provisions is to place a greater burden on the state regulatory system without providing easily accessible information necessary for that regulation. It is also clear that when a state agency discovers abuses of the types stated above, appropriate state statutes or the common law of trusts can be utliized to remedy the problem.

Publicity of Information Required from Certain Exempt Organizations and Certain Trusts Under IRC § 6104(c)

Crucial to the information flow between state and federal authorities regarding tax-exempt organizations is IRC § 6104(c). Generally, it describes the kind of information relating to private foundations which can be made available to the public or to a state agency. For example, notification is made to a state when the Internal Revenue Service refuses to recognize an organization as one described in IRC § 501(c)(3), or if such an organization has been operated in such a manner that it will no longer be recognized as meeting the requirements for exemption under that section. Similarly, a state agency is notified at the time a notice of deficiency of tax is mailed to a 501(c)(3) organization. This is particularly helpful to the agency's audit staff since imposition of a tax under chapter 42 of the IRC (§§4240-4245)[32] indicates self-dealing, lack of proper distributions, excessive business holdings, jeopardizing investments or improper expenditures.[33] Interestingly enough, however, the notices received by the states have primarily been concerned with the failure to recognize exemption rather than revocations or chapter 42 violations. It was also found, unfortunately, that when these revocation or chapter 42 violation notices are sent to the states, only a handful of them take any action.

As far as the states are concerned, the failure to recognize exemption is of little importance because state action does not hinge upon whether or not an organization is exempt. Furthermore, many of these notices are sent merely because the organization failed to transmit the required information to the Internal Revenue Service in the time specified.

It is also important to note that under this section no affirmative action need be taken by the states in order to receive these notices. However, supporting documents relating to the above determination must be requested by submitting a statement to Internal Revenue that the material is to be used solely for the fulfillment of the agency's obligations under state law.

Although 6104(c) represent a major breakthrough as far as state-federal relations are concerned, it still represents only a partial solution. Under the current Internal Revenue interpretation of IRC §6104(c), a state official is entitled to request additional information from Internal Revenue concerning a foundation's activities only after a determination (as defined in Treasury Regulation §301.6104-3(c)) is made. As a result, a state agency and Internal Revenue may be investigating the same organization, but until "all administrative review . . . has been completed . . . and the organization is sent a notice of deficiency . . . ," the state agency will not be entitled to review the investigative material.[34]

This interpretation creates numerous instances of duplication of investigative effort. In addition, since the administrative review may take years to complete, the organization whose exemption has been revoked or is found to be in violation of §4241-4245 of the IRC will possibly avoid a state audit. Because of this delay, remedies such as injunctive relief that are only available to state agencies cannot be utilized.

As a result of the above, it is suggested that the following changes be considered.

Liberalization of exchange of information (regarding 501(c)(3) organizations) between the states and the Internal Revenue Service. We are very much aware of the reasons for confidentiality of Internal Revenue Service investigative data. However, when that information involves abuses by trustees or directors of public and private foundations, the reasons for such secrecy are less apparent. If the underlying premise of charitable regulation is to encourage philanthropy and discourage breaches of fiduciary duty, it is in the best interests of both state and federal agencies to communicate in such a way as to best accomplish that purpose. Only through complete cooperation can a costly duplication of effort and a waste of taxpayer dollars be avoided. Under the present interpretations, this cannot be done. Two reasons are often stated as a basis for the Internal Revenue Service not sharing information with the states: (1) raw investigative data can be misinterpreted, and (2) confidentiality cannot be maintained. We agree with the first position, but at the same time we are not advocating that a file be turned over to the state without an explanation of its contents. If a bare fact exists without any corroboration, that can be pointed out.

With regard to confidentiality, it may be sufficient to state that historically the possibility of safeguarding such information on a state level is less than on the federal level. However, it seems clear that the benefit derived in protecting the public interest far outweighs the danger of disclosure. Better and more effective remedial action, such as injunctive relief, trustee removal or surcharge, is available to state officers. Additionally, there will be a complete availability of investigative data should a dispute go to trial.

It is firmly believed that the time has come for the communication lines to be linked and for the traditional traits of personalities and public relations (as to who gets the credit) usually found in various forms of joint state-federal regulation be set aside. A step in that direction could be accomplished by an enlightened interpretation of existing legislation.

Public foundation returns (Form 990) should be required to be sent to state attorneys general. As stated earlier, under current regulations only the annual report forms of private foundations are required to be mailed to the appropriate state officer. From a state regulatory standpoint as well as from a public information standpoint, the filing of Form 990 by public foundations would be beneficial to the states in fulfilling their public responsibilities, and it could be done at very little additional cost to the foundations.

Although it is true, as Table 7 indicates, that a substantial majority of the states do very little with the private foundation reports they are now receiving, that is not a sufficient reason for not requiring public foundation reports to be sent to the states. It must be recognized that the few states that do review the material currently being transmitted, and that are active in the regulation of charitable trusts and foundations, supervise a sizable percentage of the charitable funds in this country.

Table 7

State Utilization of the Internal Revenue Service Reporting Forms
and Contact With the Internal Revenue Service Regional Office
(As of August 1974)

State	Use of IRS 990 AR and PF Reporting Forms	Review or Examine	Nature and Extent of Contact with IRS
Alabama*	-	-	-
Alaska	None	No	None
Arkansas	None	No	None
Arizona	None - Sent to Dept. of Revenue	No	None
California	None	No	Intermittent contact. Good personal relations but some difficulty in obtaining information from the IRS.
Colorado*	-	-	-
Connecticut*	-	-	-
Delaware	None	No	Minimal
Florida	None	No	None
Georgia	Used as an Annual report	Yes	Minimal
Hawaii	None (kept on file)	No	Contact limited to IRS releases relative to exempt status of charities and foundations.
Idaho	None	No	Minimal
Illinois*	-	-	-
Indiana**	Subjected to standard examination and then referred to Dept. of Revenue	Yes	Information unavailable
Iowa	None	No	None
Kansas	None	No	The IRS has been uncooperative on 3 occasions when asked to investigate a registration with the IRS.
Kentucky	Listed by year and filed	No	None

Abuses in the Administration of Charitable Trusts and Foundations

Before exploring specific abuses, it should be understood that the determination of whether conduct by a trustee is improper and therefore constitutes an abuse is based primarily upon common law trust principles. Charitable trust statutes do not usually prohibit or proscribe specific conduct of trustees except in the area of

Table 7 (Continued)

State	Use of IRS 990 AR and PF Reporting Forms	Review or Examine	Nature and Extent of Contact with IRS
Louisiana*	-	-	-
Maine	Subjected to general examination to determine the nature of incorporation and distribution of compensation	Yes	Minimal
Maryland	None	No	Minimal
Massachusetts	Used to supplement state report form	Yes	Good Relations
Michigan	Extensive Review	Yes	Good Relations
Minnesota	None	No	None
Mississippi	None (kept on file)	No	None
Missouri	Spot checks	Yes	Minimal
Montana*	-	-	-
Nebraska*	-	-	-
Nevada	None	No	Minimal
New Hampshire	Used as cross checks	Yes	Minimal
New Jersey*	-	-	-
New Mexico	-	-	-
New York	Reviewed by accounting staff	Yes	Occasional contact with IRS
North Carolina	None	No	Minimal
North Dakota	Briefly examined	Yes	None
Ohio	Used to supplement state reporting or may be used in lieu thereof	Yes	Frequent contact; excellent rapport

private foundations (as required by §508(e) IRC) There are instances, however, where state probate codes do provide for specific conduct on the part of testamentary trustees who administer a charitable trust.[35]

A trustee's conduct must always be of the highest integrity.[36] There is a duty of loyalty which theoretically prevents him from profiting directly or indirectly as a result of holding that position.[37] He therefore must refrain from any improper

Table 7 (Continued)

State	Use of IRS 990 AR and PF Reporting Forms	Review or Examine	Nature and Extent of Contact with IRS
Oklahoma*	-	-	-
Oregon	Reviewed with particular emphasis on tax liability	Yes	Good rapport
Pennsylvania	None (kept on file)	No	None
Rhode Island	None	No	None
South Carolina	Information on adverse tax effects is forwarded to the tax commissioners (kept on file)	No	None
South Dakota	None	No	None
Tennessee	None	No	None
Texas	None (kept and filed)	No	None
Utah	Examination for compliance with Utah statute	Yes	Minimal
Vermont	None	No	None
Virginia	None	No	None
Washington	None	No	Good rapport
West Virginia	-	-	-
Wisconsin	Used as cross reference against state report	Yes	-
Wyoming	None	No	None

*Denotes no response to questionnaire

**Only state which has state statute which provides guidelines for the use of the IRS 990 series forms. Ind. Stat. Ann. 30-4-5-21 (1971).

conduct which results in self-dealing or a conflict of interest.[38] It is also his responsibility to preserve the trust property and make it productive.[39]

It should be noted that the above principles apply to fiduciaries of charitable corporations as well as to the trustees of charitable trusts. In the latter the standard is absolute, while in the former it is somewhat flexible.[40]

Data have been compiled through the use of the Ohio Attorney General's questionnaire regarding the current types of abuses encountered by regulatory authorities in the enforcement of charitable trusts and foundations. Of the 50 states sampled, only 18, or 36 percent, were able to respond. This is not to say that the results were inconclusive. The fact that only 36 percent of the states were involved in the regulation of charitable trusts to the extent that they were able to respond is a significant finding in itself. This suggests the need for greater participation by state authorities in the regulatory function.

The three most frequently reported abuses were (1) excessive fees, (2) self-dealing, and (3) the failure to correspond, register, or report. Excessive fees relate to trustee compensation as well as professional fund-raising charges in connection with a charitable solicitation. Self-dealing entails improper conduct in which the trustee personally benefits from his position of trust.

The failure on the part of the trustee or foundation managers to correspond, register, or report to the state office responsible for regulating charitable trusts and foundations ranks third in frequency of occurrence. Such action serves to prevent accessibility to information and thus makes effective regulation difficult.

Beyond the above three abuses, no one abuse was reported a sufficient number of times to be singled out for particular treatment. There was, however, a concentration of abuses under the broad heading of improper administration. This includes reports of excessive accumulation of funds, accumulation of unproductive property, poor investment policy, failure to distribute in accordance with the charitable purposes of the trust, misapplication of assets, and the lack of adequate security.

The questionnaire also revealed a number of abuses which do not lend themselves to any standard classification. These include noncompliance with the Tax Reform Act of 1969 resulting from a lack of knowledge of its provisions, abuse of power by the trustees, failure to take the steps necessary to appoint successor trustees, lack of expertise in accounting, and the failure to petition the court for deviation or *cy pres* where appropriate.

Given the amount of information received by the state regulatory authorities, it is essential that steps be taken to ensure: (1) an initial information flow between the state regulatory agency and the charitable organization community and (2) that the reports received be fully examined. The following checklist indicates the type of review made by an audit staff and the kinds of information that are required from a charitable organization which possesses assets, liabilities, expenses, or income that fall into any of the listed categories.

FINANCIAL CHECKLIST

This list is not all-inclusive and should be only used as a guide for determining or discovering abuses.

Many of these items are based upon an audit guide used by the New York and Ohio Attorney General.

1. Cash
   - (a) Commercial or savings account
   - (b) Control – who has authority to expand
   - (c) If bank is trustee - would cash in a non-interest bearing account be a form of indirect self-dealing
2. Unproductive Investments
3. Jeopardizing Investments
   - (a) Under IRC - short sales, puts, call, warrants, commodities
   - (b) Imprudent Investments

4. Execessive Trading
    - (a) By brokers (churning)
    - (b) By non-brokers

5. Loans and Notes Receivable
    - (a) Inadequate or non-interest bearing
    - (b) Non-collateralized
    - (c) Self-dealing
        - (1) to whom were the loans made
        - (2) relationships involved

6. Mortgages Receivable
    - (a) Second mortgages, inadequate interest, self-dealing, inadequate collateral, relationships involved

7. Transactions Between Related Parties (self-dealing)
    - (a) Where relationship is referred to in any schedule or question appearing in the report, or discovered during the course of investigation it means:
        - (1) The creator, substantial contributor, officer, director, or trustee of the organization and relatives by blood or marriage of such persons
        - (2) Business or nonprofit ventures controlled, indirectly or directly, by anyone listed in (1) above
        - (3) Employees of anyone listed in (1) or (2) above
    - (b) Where any of above relationships exist, note schedule, name, type of relationship, and full details of any transactions

8. Works of Art
    - (a) Inquiries should be made into the following:
        - (1) Description, title, artist, and date acquired
        - (2) Indicate how acquired (gift or purchase) and value at date of acquisition by organization. If purchased, give vendor's name and relationship (See General Instruction 1)
        - (3) Institution or gallery where exhibited and portion of year art object was on exhibition
        - (4) Name and address of person in possession of these art objects when they are not on exhibition
        - (5) Current market value
        - (6) Insurance coverage for fire and theft

9. Life Insurance
    - (a) Inquiries should be made into the following:

    - (1) Name of insured, insurance company, policy number, date issued, type of policy, face amount, annual premium, and by whom paid
    - (2) When and how policy was acquired by the organization and terms of acquisition
    - (3) Name of beneficiary and if designation is irrevocable
    - (4) Amount of loans outstanding against policy and cash surrender value at report date
    - (5) Description of interest of others in policy including the right to assign, borrow, or otherwise deal with the policy

10. Disposition of Assets by Foundation
    - (a) Was fair market value received, arms length
    - (b) Disposition includes an exchange

11. Worthless Assets

12. Loans, Notes, Mortgages Payable, Accounts Payable
    - (a) Type of payable
    - (b) Creditor's name, address, and relationship to the organization
    - (c) Amount and date of original liability, current balance and amount in arrears (if any)
    - (d) Details of interest rate, annual required amortization and maturity date
    - (e) Description of collateral or security
    - (f) How and why liability originated
    - (g) Use to which borrowed funds were applied

13. Non-Permissible Grants
    - (a) Check creating instrument

14. Real Estate
    - (a) Market Value
        - (1) Asset description and location
        - (2) Date acquired and acquisition cost (purchase price or donated value) to the organization; if acquired by purchase, relationship of seller to the organization
        - (3) Current market value, total of all mortgages and liens against property, fire and liability coverage
        - (4) On rental properties indicate percentage of building occupied by
            - (a) Organization
            - (b) Related parties
            - (c) Others

(5) If any part of these premises is occupied by the donor, creator or related parties, an annual rent roll should be submitted showing details of all rental units, including units for which no rent is charged

(6) A statement as to whether these properties are exempted from payment of real estate taxes: if not, explain

15. Compensation (reasonable or unreasonable)

16. Other Assets (if unspecified)

17. Interlocking Directorates

18. Where grants are made to or for individuals, inquiries may be made into method of choosing recipient, conditions attached and results obtained.

19. Possible Violations Under IRC §§4941-4945

20. Excessive Expenses

21. Security Losses
    (a) Realized
    (b) Unrealized

22. Closely Held Stock
    (a) Sales
    (b) Percent of ownership by organization
    (c) Who votes the stock
    (d) Income yield
    (e) Other

In conclusion, the lack of activity on the part of a number of states coupled with serious abuses in the areas of excessive fees, self-dealing, and improper administration indicates a need for further involvement by many state attorneys general if the public's charitable dollars are to be fully protected and utilized. Additionally, in those states actively involved in such regulation, there is a need for more information from the charitable trust and foundation community in order that the most effective and meaningful regulation can be achieved.

The Feasibility of Uniform Charitable Trust and Foundation Legislation

The movement toward reform legislation designed to cure the deficiencies in charitable trust enforcement in this country apparently began with the publication of Professor Austin Wakeman Scott's definitive work on trusts which indicated the need for state supervision and regulation of charitable trusts and foundations. It was Professor Scott's conclusion that while the respective state attorneys general were widely acknowledged to possess the power to enforce charitable trusts, they lacked, without exception, the necessary information to fulfill their duties.[41]

Professor Scott's exposition of the problem led to the adoption in 1943 in the state of New Hampshire of this country's first registration and reporting statute. (N.H. Laws of 1943, Ch. 181.) In the decade that followed, four states enacted statutes patterned after the New Hampshire legislation. The first of these was Rhode Island in 1950, followed by Ohio, South Carolina, and Massachusetts in 1953.[42]

In 1954 the National Conference of Commissioners on Uniform State Laws approved a model registration and reporting act entitled the "Unform Supervision of Trustees for Charitable Purposes Act."[43] This model act was based substantially on earlier state legislation and, as is stated in the prefatory note, was designed to accomplish the following:

> (1) It requires trustees and others holding funds for charitable purposes to report the existence of the trust relationship to the Attorney General and to make subsequent periodic reports to him.
>
> (2) The nature and frequency of the administrative report is left to the rule-making powers of the Attorney General who also has the right, for good cause, to suspend reporting when the public interest does not require it.
>
> (3) Gifts to charitable corporations, not restricted as to purpose, as well as gifts to religious, educational, and hospital charitable corporations, and to state agencies are exempted.
>
> (4) The Attorney General is given appropriate investigating, discovery, and enforcement powers.

Initially, the model legislation was objected to on the grounds that "(1) it is unnecessary (all trustees or the vast majority of them are honest), (2) it will cause an unnecessary burden and hardship on the trustees, many of whom serve without compensation, (3) the filing of audits and reports is an expensive procedure and will result in wasting the assets of the estate, and (4) interference by government in the administration of private funds will deter potential donors."[44]

Most state authorities, however, have adopted the approach of Professor Karst toward model legislation. He states:

> A number of accomplishments may be chalked up for the reporting laws. Probably their most important effect has been the awakening of "dormant" trusts which had been inactive before the reporting statutes went into effect. The mere existence of the requirement that a report be made to an official apparently has had a galvanic effect on a number of honest but inactive trustees . . .
>
> Another achievement claimed for the legislative schemes is that their very existence has caused trustees to be scrupulous in their dealings, and thus has saved some charities from losses . . .
>
> So the reporting laws are a beginning; the great majority of states which do not have any such legislation would do well to copy the few which do . . .
>
> . . . the money spent on supervision is repaid over and over in savings to the public.
>
> . . . [A]ll of the supervision suggested here and elsewhere is designed to put information into the hands of public officials, information to which any private-trust beneficiary would clearly be entitled. These suggestions do no more than to substitute a flesh-and-blood official for "the public", the indefinite beneficiary of charity.[45]

Although several writers including Karst have advocated "... the establishment of a new agency on the state level to bear primary responsibility for supervising private charities and for administering the various state controls over their operation," most commentators have thought that the state attorneys general, with the aid of a registration and reporting statute like the Uniform Act, are adequate to perform the task.[46] (See page 2726 for statistics and comments on the participation of the various state attorneys general in the regulatory function.)

There are nine basic features in the Uniform Act. Two of these, the definition and exemption sections, establish the scope of the act. The essential substantive provisions of the act are contained in the registration and reporting sections which prescribe the duties of trustees of charitable trusts. The powers of the attorney general are enumerated in the sections that grant him rule-making, subpoena, and enforcement powers. There are also two sections designed to give the attorney general information concerning the creation of charitable trusts. Additionally, there is one section which provides that the information filed with the attorney general shall be open to public inspection.

In the pages that follow, the main provisions of the registration and reporting statutes in four of the states that have been active in the enforcement of charitable trusts will be compared and contrasted with the provisions of the Uniform Act. Three of these states, California, Illinois, and New York, have adopted legislation patterned substantially after the Uniform Act. The legislation in the fourth state, Ohio, with the exception of style, is also similar to the Uniform Act.

Section 1 of the Uniform Act provides that the "... act applies to all trustees holding property for charitable purposes over which [the state or] the Attorney General has enforcement or supervisory powers." The purpose of this section was to limit the scope of that act to those charitable trusts over which the attorneys general had enforcement or supervisory powers prior to the adoption of the act. Of the four states, only California, where the Uniform Act was adopted practically verbatim, and New York, have similar clauses. Cal. Govt. Code §12581 (West 1959); N.Y. Est., Powers and Trusts Law §8.1-4(a)(1) (McKinney 1966).

Section 2 of the Uniform Act, which defines the word "trustee" for the purposes of the act, has caused many problems of coverage.

Clause (b) of section 2 which seems to provide an exemption for corporations accepting property to be used for their own general purposes has given the most difficulty, since the word "trust" is not used to describe the nature of the ownership of property as it is in clauses (a) and (c).

> SECTION 2. [*Definition of Trustees*] "Trustees" means (a) any individual, group of individuals, corporation, or other legal entity holding property in trust pursuant to any charitable trust, (b) any corporation which has accepted property to be used for a particular charitable corporate purpose as distinguished from the general purposes of the corporation, and (c) a corporation formed for the administration of a charitable trust, pursuant to the directions of the settlor or at the instance of the trustee.

Marion Fremont-Smith in commenting on this section stated:

> ... [S]ince the word "trust" is not used, the language could be taken to mean that it includes more than those situations where a donor has made an absolute gift to a charitable corporation but the corporation has indicated its intention to apply the funds to a particular purpose. It may also include those instances where the donor has expressed in prefatory language a desire to have the property applied to a particular purpose; in this case the corporation would be placed in the anomalous position of being required to report on the disposition of the funds even though it was under no legal obligation to apply them to the specific purposes and would otherwise be exempted from the operation of the act.

Further difficulty is caused by the fact that in those jurisdictions in which the funds of charitable corporations have been construed by the Courts to be held "in the nature of a trust" or to be "quasi-trusts," it is impossible to determine whether the language of clauses (a) and (c) would require reporting by all charitable corporations not specifically exempted as being for educational, religious, or hospital purposes. Furthermore, when trustees of a charitable trust subsequently receive court permission to incorporate, a question arises as to whether they are then holding their property in trust within the meaning of the act.[47]

Section 2(b) has also been criticized for perpetuating the view that a distinction should be made between the duties of directors of charitable corporations and the duties of trustees of charitable trusts despite the fact that this distinction is based on form rather than substance: "The present statutory requirements are obviously a great improvement over the condition of nearly complete official ignorance which formerly prevailed. Yet there remains a serious gap in the coverage of several of the enacted schemes which fail to require registration or reporting of charitable corporations. On principle, such an exception is absurd."[48]

California recognized such weaknesses in the wording of section 2 of the Uniform Act and amended its statute in 1959 to apply to "... all charitable corporations and trustees holding property for charitable purposes." Cal. Govt. Code, §12581 (West 1959). A section which was added at that time defined a charitable corporation as "... any nonprofit corporation organized under the laws of this State for charitable or eleemosynary purposes and any similar foreign corporation doing business or holding property in this State for such purpose." Cal. Govt. Code, §12582.1 (West 1959).

In Illinois where a modified version of the Uniform Act has also been adopted, the statute was amended in 1963 so that the term "trustee" was defined as "... any individual, group of individuals, corporation or other legal entity holding property for any charitable purpose." Ill. Rev. Stat., Ch. 14 §53. The Illinois act is somewhat unusual in that it is made applicable only to trustees "... holding property of value in excess of $4,000 ..." Ill. Rev. Stat., Ch. 14 §52 (1961).

New York's legislation defines "trustee" to mean "... any individual, group of individuals, corporation or other legal entity holding and administering property for charitable purposes." N.Y. Est. Powers & Trusts Law, §8-1.4(a) (McKinney 1966).

The Ohio statute defines a "charitable trust" as "... any fiduciary relationship with respect to property arising as a result of a manifestation of intention to create it, and subjecting the partnership, corporation, person, or association of persons by whom the property is held to equitable duties to deal with the property for any charitable, religious or educational purpose." Ohio Rev. Code Ann., §109.23 (1953 as amended). A bill proposed in the Ohio General Assembly would amend this definition as follows:

> ... (b) "Charitable Trust" includes the fiduciary relationship, the entity serving the trustee, the status as trustee, the corpus of such trust, or a combination of any or all of such meanings, regardless of the primary meaning of any use of the term, that is necessary in any circumstances to effect the purposes of such sections.
>
> (c) An executor, administrator, guardian, or other conservator of the estate of a decedent, incompetent, or other similarly protected person is, when holding assets in which a charitable trust has a vested or contingent interest and to the extent that such sections are not clearly inapplicable, to be considered a fiduciary of a charitable trust.
>
> (d) The fact that any person sought to be charged with fiduciary duties is a corporation, association, foundation, or any other type of organization that

> has, under judicial decisions or other statutes, been distinguished from a charitable trust does not provide a presumption against its being a charitable trust as defined in this section.

This proposed Ohio legislation also eliminates the last two sentences of § 109.23 of the Ohio Revised Code, which provides exemptions for trusts that have not yet become ". . . vested in use or enjoyment . . ." and for ". . . charitable, religious and educational institutions holding funds in trust or otherwise exclusively for their own purposes." The bill would also eliminate the exemption ". . . to institutions created and operated as agencies of the state government or any political subdivision thereof." The first two eliminated exemptions of the present §109.23 have been criticized as providing "for an exemption from the Act which could be read as practically coextensive with the definition itself."[49]

Section 3 of the Uniform Act provides for exclusions from the terms of the act and reads as follows:

> SECTION 3. [*Exclusions from the Act.*] This act does not apply to the United States, any state territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or to any of their agencies or governmental subdivisions, to an officer of a religious organization who holds property for religious purposes, or to a charitable corporation organized and operated primarily for educational, religious, or hospital purposes.

One of the major problems faced by the drafters of the Uniform Act was defining the organizations that would fall within the scope of the act. Largely for the purpose of overcoming political opposition, the final draft excluded religious, educational and hospital institutions.[50]

Ohio, which has already been discussed as to existing and proposed legislation, California, New York, and Illinois all have statutes which contain exclusion clauses similar to section 3 of the Uniform Act. The California act also exempts cemetery corporations. Cal. Govt. Code, §12583 (West 1959). The New York act extends its exemption to ". . . fraternal, patriotic, veterans, volunteer firemen, social or alumni organizations and historical societies chartered by the New York state board of regents." N.Y. Est., Powers and Trusts Law, §8-1.4(a)(6) (McKinney 1966). The New York act also exempts ". . . any trust in which and so long as the charitable interest is deferred or contingent." N.Y. Est., Powers & Trusts Law §8-1.4(a)(8) (McKinney 1966). The Illinois act exempts cemeteries and homes for the aged. Ill. Rev. Stat., Ch. 14 §54 (1961).

The wisdom of the inclusion of some or all of these exclusions in virtually all registration and reporting statutes has been widely criticized.[51]

Section 4 of the Uniform Act, pertaining to the establishment of a register of trustees, is one of the principal substantive sections and reads as follows:

> SECTION 4. [*Register of Charities.*] The Attorney General shall establish and maintain a register of trustees subject to this act and of the particular trust or other relationship under which they hold property for charitable purposes and, to that end, shall conduct whatever investigation is necessary, and shall obtain from public records, court officers, taxing authorities, trustees, and other sources, whatever information, copies of instruments, reports and records are needed for the establishment and maintenance of the register.

California, Illinois, and New York each have sections in their statutes that are substantially identical to this section of the Uniform Act. Cal. Govt. Code, §12584 (West 1959); Ill. Rev. Stat., Ch. 14 §55 (1961); N.Y. Est., Powers and Trusts Law,

§8-1.4(c) (McKinney 1966). The Ohio statute contains a section which provides that "... the attorney general shall prepare and maintain a register of all charitable trusts established as active in this state." Ohio Rev. Code Ann. §109.26 (1953 as amended).

Section 5 of the Uniform Act imposes a duty on every trustee subject to the act to file a copy of the trust instrument with the attorney general:

> SECTION 5. [*Filing Copies of Instruments.*] Every trustee subject to this act who has received property for charitable purposes shall file with the Attorney General, within six months after any part of the income or principal is authorized or required to be applied to a charitable purpose, a copy of the instrument providing for his title, powers or duties. If any part of the income or principal is authorized or required to be applied to a charitable purpose at the time this act takes effect, the filing shall be made within six months thereafter.

The New York statute contains a section that is substantially identical to this section. N.Y. Est. Powers and Trusts Law, §8-1.4(d) (McKinney 1966). The California statute is similar but it has been broadened to include "... every charitable corporation and trustee." Also, the words "... articles of incorporation or other instrument" appear in place of the word "instrument." Cal Govt. Code, §12585 (West 1959). The corresponding section of the Illinois statute is similar but the words "... trust agreement, articles of incorporation or other written instrument" have been substituted for the word "instrument." The Illinois act also requires that trustees holding property for charitable purposes without a written instrument file a statement with the attorney general. In addition, the Illinois statute exempts banks and trust companies from the registration section. Illinois Rev. Stat., Ch. 14 §56 (1961). The Ohio statute contains no similar section requiring the filing of a copy of the trust instrument but proposed legislation provides that all charitable trusts be registered within six months after the effective date of the section or within six months after the creation of the trust.

Section 6 of the Uniform Act requires every trustee subject to the act to file periodic written reports with the attorney general:

> SECTION 6. [*Filing of Periodic Reports.*]
>
> (a) Except as otherwise provided, every trustee subject to this act shall, in addition to filing copies of the instruments previously required, file with the Attorney General periodic written reports, under oath, setting forth information as to the nature of the assets held for charitable purposes and the administration thereof by the trustee, in accordance with rules and regulations of the Attorney General.

The section further provides the attorney general with extensive rule-making power in respect to the manner in which such reports are received.

> (b) The Attorney General shall make rules and regulations as to the time for filing reports, the contents thereof, and the manner of executing and filing them ...

Paragraph (b) also permits the attorney general to suspend the filing of reports in certain situations if he feels the interests of the beneficiaries will be served. Paragraph (c) permits the filing of an account in some situations in place of the periodic report, and paragraph (d) requires that the first report be filed not later than one year "... after any part of the income or principal is authorized or required to be applied to a charitable purpose."

The California and New York statutes are substantially identical to this portion of the Uniform Act; Cal. Govt. Code § 12586 (West 1959); N.Y. Est., Powers &

Trusts Law § 8-1.4(f)-(h) (McKinney 1966). The Illinois statute is also identical in all material respects but it contains an exemption with regard to pending litigation: "(e) The periodic reporting provisions of this Act do not apply to any trustee of a trust which is the subject matter of an adversary proceeding pending in a court of competent jurisdiction in this State . . ." Ill. Rev. Stat., Ch. 14 §57(e) (1961).

The Ohio statute does not contain a section patterned after the Uniform Act, but section 109.27 of the Ohio Revised Code grants to the attorney general the power to make ". . . such rules and regulations . . . as he may deem necessary to secure records and other information for the operations of the register of charitable trusts." Also, section 109.31 requires all charitable trusts to make biennial reports, unless otherwise directed, to the attorney general. The proposed Ohio legislation would require annual reports or complete copies of all annual federal returns required to be filed by the trust with the Internal Revenue Service. This proposed legislation also provides for an exemption from filing for any taxable year in which the trust has gross receipts of less than $5,000.

Section 7 of the Uniform Act provides that "[t]he Attorney General may make additional rules and regulations necessary for the administration of this Act." This section was apparently designed to make clear that the attorney general's rule-making powers were not limited to matters pertaining to the filing of periodic reports. California and Illinois have similar sections but New York and Ohio do not. Cal. Govt. Code §12587 (West 1959); Ill. Rev. Stat., Ch. 14 §58 (1961). Ohio's proposed legislation corrects this by providing that the attorney general shall make such rules and regulations as are necessary to administer the act.

Sections 8 and 9 of the Uniform Act give the attorney general broad subpoena powers:

> SECTION 8. [*Investigation.*] The Attorney General may investigate transactions and relationships of trustees subject to this act for the purpose of determining whether the property held for charitable purposes is properly administered. He may require any agent, trustee, fiduciary, beneficiary, institution, association, or corporation, or other person to appear, at a named time and place, in the county designated by the Attorney General, where the person resides or is found, to give information under oath and to produce books, memoranda, papers, documents of title, and evidence of assets, liabilities, receipts, or disbursements in the possession or control of the persons ordered to appear.
>
> SECTION 9. [*Order to Attend.*] When the Attorney General requires the attendance of any person, as provided in section 8, he shall issue an order setting forth the time when and the place where attendance is required and shall cause the same to be delivered to or sent by registered mail to the person at least 14 days before the date fixed for attendance. Such order shall have the same force and effect as a subpoena, and, upon application of the Attorney General, obedience to the order may be enforced by any court having jurisdiction of charitable trusts in the county where the person receiving it resides or is found, in the same manner as though the notice were a subpoena. The court, after hearing, for cause on an application of any person aggrieved by the order, shall have the right to alter, amend, revise, suspend or postpone all or any part of its provisions.

The provisions of the California, New York, and Illinois statutes are substantially identical to the Uniform Act in all material respects. Cal. Govt. Code, §§12588-9 (West 1959); N.Y. Est., Powers & Trusts Law, §§8-1.4(i)-(k) (McKinney 1966); Ill. Rev. Stat., Ch. 14 §§59-60 (1961). The Ohio statute is notably deficient because it does not provide the attorney general with subpoena powers. However, the proposed legislation would amend existing section 109.24 of the Ohio Revised Code to include a somewhat limited subpoena power.

Section 10 of the Uniform Act provides that "... *subject to reasonable rules and regulations adopted by the Attorney General the register, copies of instruments and the reports filed with the Attorney General shall be open to public inspection.*" The Illinois statute adopts this language verbatim. Ill. Rev. Stat., Ch. 14 §61 (1961). The corresponding section of the California statute is practically identical but additionally provides that the "... Attorney General shall withhold from public inspection any instrument so filed whose content is not exclusively for charitable purposes." Cal. Govt. Code, §12590 (West 1959). The New York statute permits the Attorney General to withhold from public inspection reports filed with other governmental agencies required by law to be kept confidential. N.Y. Est., Powers & Trusts Law, §8-1.4(1) (McKinney 1966). The Ohio statute permits public inspection "... for such legitimate purposes as the attorney general may determine; provided, however, that any investigation of a charitable trust shall not be open to public inspection." Ohio Rev. Code Ann. §109.28 (1953 as amended).

Section 11 of the Uniform Act pertains to the enforcement powers of the attorney general and reads as follows:

> SECTION 11. [*Powers of Attorney General and Courts.*] The Attorney General may institute appropriate proceedings to secure compliance with this act and to secure the proper administration of any trust or other relationship to which this act applies. The powers and duties of the Attorney General provided in this act are in addition to his existing powers and duties. Nothing in this act shall impair or restrict the jurisdiction of any court with respect to any of the matters covered by it.

This section preserves whatever common law or statutory powers and duties the Attorney General possessed prior to the adoption of the act. California, New York, and Illinois all have substantially identical provisions. Cal. Govt. Code §12591 (West 1959); N.Y. Est., Powers & Trusts Law, §8-1.4(m) (McKinney 1966); Ill. Rev. Stat., Ch. 14 §62 (1961). The existing Ohio statute grants to the attorney general similar enforcement powers by providing that "[t]he attorney general shall institute and prosecute a proper action to enforce the performance of any charitable trust, and to restrain the abuse thereof whenever he deems such action advisable ..." Ohio Rev. Code Ann. §109.24 (1953 as amended). This section, however, does not contain language to the effect that the powers and duties of the attorney general provided in this act are in addition to his existing powers and duties. Section 109.26 of the Ohio Revised Code does state that "[i]n addition to all his common law and statutory powers, the attorney general shall prepare and maintain a register of all charitable trusts ..." However, this language is subject to the interpretation that it applies only to the preparation of the register and is not a recognition of the attorney general's common law powers with respect to charitable trusts in general. This ambiguity would be cured by the proposed Ohio legislation, which would amend section 109.24 to state that the powers of the attorney general under the entire charitable trust section "... shall be in addition to and not in limitation of his powers held at common law."

Similar to California and New York, the Ohio statute provides that the attorney general is a necessary party to all charitable trust proceedings. Ohio Rev. Code Ann. §109.25 (1953 as amended); Cal. Govt. Code §12591 (West 1959); N.Y. Est., Powers & Trust Law §8-1.4(m) (McKinney 1966). Illinois does not have such a section. This is an important and necessary provision which should be made a part of any uniform legislation.

> Notification to the attorney general whenever application to the courts is made is essential if the public interest is to be represented. If an annual or triennial accounting is made to the attorney general, he can merely examine the stewardship of the trust to determine whether or not he will initiate any

> action. But the public interest may be seriously jeopardized when property is bought or sold or put to uses other than those specified in the trust instrument. It will be of little use to the public for the attorney general to learn of these facts after the event in a regular periodic accounting.[52]

Section 12 of the Uniform Act states simply that the "... act shall apply regardless of any contrary provision of any instrument." New York, California, and Illinois have adopted such a provision. N.Y. Est., Powers & Trusts Law, §8-1.4(n) (McKinney 1966); Cal. Govt. Code §12592 (West 1959); Ill. Rev. Stat., Ch 14 §62 (1961). Only the Ohio statute fails to carry a similar provision. The proposed legislation fails to remedy this deficiency.

Sections 13 and 14 of the act are designed to give the attorney general information about the creation of charitable funds. These sections read as follows:

> SECTION 13. [*Custodians to Furnish Copies of Instruments.*] The custodian of the records of a court having jurisdiction of probate matters or of charitable trusts shall furnish such copies of papers, records and files of his office relating to the subject of this act as the Attorney General requires.
>
> SECTION 14. [*Duties of Tax Authorities.*] Every officer, agency, board or commission of this state receiving applications for exemption from taxation of any charitable trust or similar relationship in which the trustee is subject to this act shall annually file with the Attorney General a list of all applications received during the year.

The Illinois act omits both of these sections. New York omits section 13. California and Ohio have statutory provisions similar to section 13. Cal. Govt. Code, §12593 (West 1959); Ohio Rev. Code Ann. §§109.29-30 (1953 as amended). Section 109.30 of the Ohio Revised Code expressly requires that notice be given to the attorney general after the probate of a will which purports to create a charitable trust. Only California and New York have statutory provisions similar to section 14 of the Uniform Act. Cal. Govt. Code, §12594 (West 1959); N.Y. Est., Powers & Trusts, §8-1.4(o) (McKinney 1966).

The Uniform Act fails to consider the question of how the costs of administering the act will be paid. It is assumed that the commissioners intended the costs to be borne by the attorneys general. Only the New York Statute solves this problem by providing for filing fees. N.Y. Est., Powers & Trusts Law, §8-1.4(p) (McKinney 1966). These fees are scheduled according to the net worth of the trust property. The proposed Ohio legislation in section 109.31 contains a fee schedule also based upon the net worth.

The Uniform Act also fails to provide any sanctions for trustees who fail to register or report. The existing Ohio statute is somewhat unclear, but it does seem to provide for sanctions: "... Refusal to file such a report shall constitute a breach of trust and the attorney general shall take such action as may be appropriate to compel compliance herewith." Ohio Rev. Code Ann., §109.31 (1953 as amended).

The proposed Ohio legislation would strengthen this provision so that "...the willful failure of any trustee to file reports as required by this section may be grounds for judicial removal of said trustee responsible for such failure." The Illinois statute does not contain any sanctions, while the New York statute provides that the "...failure of any trustee to register or to file reports as required by this section may be grounds for judicial removal of any person responsible for such failure." N.Y. Est., Powers & Trusts Law, §8-1.4(m) (McKinney 1966).

The California statute contains a unique sanction relating to any successful proceeding brought by the attorney general to secure compliance with the provisions of the act by providing that "...the person having the responsibility or *duty to comply with such provisions. . .shall pay the reasonable expense necessarily incurred by the state in the investigation and prosecution of such action.*" Cal. Govt. Code, §12597 (West 1959). The proposed Ohio legislation would amend section 109.24 of the Ohio Revised Code to include a similar provision.

By way of conclusion, it can be said that the Uniform Act, with the exception of its definition and exemption sections, probably contains all of the basic elements necessary for the establishment of an effective supervisory program. This is evidenced by the fact that the provisions of this act have been adopted by those states that have been most active in enforcing charitable trusts. However, the National Conference on Uniform State Laws should give further thought to the following:

1. The inclusion of a section that provides for sanctions for trustees who fail to register or report or who otherwise commit a breach of trust.

2. The inclusion of a section which makes the attorney general a necessary party to all judicial proceedings affecting charitable trusts.

3. The inclusion of a section which lists a suggested schedule of filing fees for the filing of reports so that costs of administering the act might be defrayed.

4. The inclusion of uniform registration and reporting forms to relieve the burden on trustees who may be required to file different reports in several jurisdictions.

Although this list is not all-inclusive, it represents the major changes which should be considered.

This discussion of uniform legislation of charitable trusts would not be complete without at least mentioning that in 1972 the National Conference of Commissioners on Uniform State Laws adopted the "Uniform Management of Institutional Funds Act."[53] In the prefatory note to the Uniform Act its basic provisions are listed as providing:

(1) a standard of prudent use of appreciation in invested funds;

(2) specific investment authority;

(3) authority to delegate investment decisions;

(4) a standard of business care and prudence to guide governing boards in the exercise of their duties under the Act; and

(5) a method of releasing restrictions on use of funds or selection of investments by donor acquiescence or court action.

The act is designed to dispose of the real or imaginary legal impediments which restrict the powers of trustees and managers of eleemosynary institutions, especially colleges and universities, to invest endowment funds to achieve growth, to maintain purchasing power, and to expend a prudent portion of appreciation in endowment funds.[54]

It is still too early to determine what the impact of this act will be on the regulation of charitable trusts and foundations. However, several questions have already been raised.[55] Initially "...there is a constitutional question as to whether application of the Act to existing gifts is simply an administrative change rather than a substantive change in the rights of the public which would amount to a taking without due process of law."[56] Secondly, "...there is a sizeable question as to whether the total return concept should, as a matter of policy, be applied to charitable endowments."[57]

Additionally, questions have been raised with respect to the retroactivity of the act, and with respect to the rules of construction found in section 3 of the act. Section 3 provides that the ordinary restrictions placed on expenditures from principal, as opposed to income, shall not be observed insofar as net appreciation is concerned. This section of the act seeks to avoid the historic problems of allocating funds between principal and income. It also seeks to avoid the problem of designating the class of funds from which expenditures may be made.

Finally, questions have been raised with respect to the adoption of a corporate standard of conduct, the availability of *cy pres* without resort to the judicial process, and the delegation of investment authority.[58]

Despite the above, the Committee on Charitable Giving has concluded that (1) the act is constitutional; (2) the act should be applied retroactively since under modern conditions, the proposed rule of construction may properly be applied to all gifts even to the extent of undoing the obvious intent of earlier donors, and; (3) the standard of conduct is adequately stated.[59]

The effect of the Uniform Management of Institutional Funds Act will have to be considered by any state undertaking to strengthen existing legislation or adopting new charitable trust and foundation legislation. This is especially true of the sections dealing with the trustee standard of conduct and the organizations included within its scope. If states do not draft their charitable trust and foundation legislation carefully, there might be conflict or overlap. On the whole, the Uniform Management of Institutional Funds Act has stimulated debate in the charitable organization community, both state and private, and this can only be beneficial to effective and meaningful state regulation.

II

THE REGULATION AND SUPERVISION OF CHARITABLE SOLICITATIONS

Comparative Analysis of Charitable Solicitation Statutes and State Regulatory Agencies

Of equal importance – from a state viewpoint – as the regulation of charitable trusts and foundations is the state role in regulating solicitations by charitable organizations. From a public viewpoint, however, the states' interest ought to be greater. This is true primarily because of the greater numbers of persons affected by a solicitation abuse than by a breach of fiduciary duty by a charitable trustee. The impetus for the development of regulatory powers in this area is not difficult to understand in light of the increased demand for the charitable dollar. It is not uncommon to encounter mass public solicitation campaigns which are performed on a statewide if not a nationwide basis. In addition to the geographic scope of solicitation appeals, these campaigns are often carried out by highly organized and experienced personnel.

With the above facts in mind, an analysis, both procedurally and substantively similar to the review of charitable trusts and foundations, was performed. Basically, an examination was made of the characteristics of the various state statutes and of the agencies responsible for the enforcement of their provisions.

Historically, the attorney general's common law power over charities in general has been interpreted to include the administration of funds raised through charitable solicitations.[60] These powers are derived on the basis that solicitation appeals are for the most part carried out in the name of and for the benefit of a charitable entity. While the historic common law powers of the attorney general over charitable solicitations are not as well defined as they are over charitable trusts, many states have compensated for this discrepancy by enacting specific statutory provisions.

As of August 1974, 31 states have enacted some form of charitable solicitation statute. A listing of these states and the citation to their corresponding statute is contained in Table 8. The substantive sections of these acts, set out in Table 9, provide for (1) registration of charitable organizations, (2) annual financial reports, (3) a limitation on the amount of payments to professional fund raisers or solicitors, (4) a requirement that written contracts with professional fund raisers or solicitors be filed with the regulatory agency within a certain period, and (5) registration of professional fund raisers and solicitors.

In terms of the survey results, of the 47 states responding to both the Ohio Attorney General and C.O.A.G. questionnaires, as indicated by Table 10, only 9 states report that the attorney general has primary responsibilities for regulation. Five of these states – Illinois, Massachussetts, New Jersey, Ohio, and Oregon – do so by charitable solicitation statute. The remaining four, which recognize the full regulatory authority of the attorney general, do so on the basis of common law or state statute other than a solicitation statute. These four states are Alaska (fraud statute), Arizona (common law), Delaware (common law), and Michigan (charitable trust statute).

In 15 states, responsibility for prosecution of abuses and administration (such as registration and reporting) and investigation are divided between two state agencies. Twelve of these states create this split function by a charitable solicitation statute. These states are Georgia, Iowa, Kansas, Maine, New York, North Dakota, Oklahoma, Pennsylvania, South Carolina, Virginia, Wisconsin, and Washington. In the remaining three states (Hawaii, Minnesota, and North Carolina) the split function is created by some statute other than the state charitable solicitation statute.

In the remaining 23 of the total 47 states the attorney general is not the recognized regulatory or enforcement agency. In these states a variety of other agencies exercise authority over charitable solicitations. The state agencies include the secretary of state or some appropriate division thereunder and the Department of Commerce. Pennsylvania and South Carolina, among others, have created separate specialized agencies to deal specifically with charitable solicitations.

Unlike the area of charitable trusts where very few states report activity on the part of local governmental units, almost half of the 38 states responding solely to the Ohio Attorney General's questionnarie report some activity on the part of local government with regard to charitable solicitations. For the most part, authority is based on ordinances which regulate door-to-door campaigns or which require some form of local permit before a solicitation may be undertaken. The extent of the regulatory activity is difficult to ascertain in light of the absence of record keeping. It is fair to assume, however, that larger municipalities would be more active.[61]

As is true in the area of charitable trusts and foundations, the most elaborate and comprehensive regulatory scheme is only effective if there is an operative staff charged with the responsibility of enforcing it. Table 11 illustrates the number of persons employed (in either a full- or part-time capacity) exclusively by the respective attorney general's offices. Out of a total of 44 states responding to this question in both the Ohio Attorney General and C.O.A.G. questionnaires, seven report having at least one attorney assigned on a full-time basis: Illinois, Massachusetts, Michigan, New York, North Carolina, Ohio, and Oregon. Eleven states report having at least one attorney assigned on a part-time basis: Delaware, Georgia, Idaho, Maryland, Minnesota, New Hampshire, New Jersey, South Carolina, Utah, Washington, and Wisconsin.

Registration and reporting requirements are crucial in any regulatory process, not only with respect to the charitable organization, but also with respect to the professional fund raising staff which it may employ. Professional fund raisers and fund raising counsel often operate out of state. Unlike charitable trusts and

Table 8

Basis for Regulation of Charitable Solicitations and Fund Raising
(As of August 1974)

Alabama	None
Alaska	None
Arizona	None
Arkansas	Ark. Stat. Ann. sec. 64-1601 et. seq. (1959)
California	Cal. Bus. & Prof. Code sec. 17510 et. seq. (West 1972)
Colorado	None
Connecticut	Conn. Gen. Stat. Ann. sec. 17-21e et. seq. (1963) as amended (1973)
Delaware	None
Florida	Fla. Stat. Ann. sec. 496.01 et. seq. (1972)
Georgia	Ga. Code Ann. sec. 35-1001 et. seq. (1962)
Hawaii	Hawaii Rev. Stat. ch. 467B (1969) as amended (1971)
Idaho	None
Illinois	Ill. Ann. Stat. ch. 23 sec. 5101 et. seq. (1963) as amended (1973)
Indiana	None
Iowa	Iowa Code Ann. sec. 122.1 et. seq. (1949) as amended (1967)
Kansas	Kan. Stat. Ann. sec. 17-1706 et. seq. (1964) as amended by H.B. NO. 1452, Laws 1974
Kentucky	Ken. Rev. Stat. Ann. sec. 196.250
Louisiana	None
Maine	Me. Rev. Stat. Ann. tit. 22, sec. 3151 et. seq. (1955) as amended (1973)
Maryland	Md. Ann. Code art. 41, sec. 103A et. seq. (1964)
Massachusetts	Ann. Laws of Mass. ch. 68 sec. 18 et. seq. (1964) as amended (1972)
Michigan	Mich. Comp. Laws Ann. sec. 400.301 et. seq. (1961) as amended (1965)
Minnesota	Minn. Stat. Ann. sec. 309.50 et. seq. (1961) as amended (1973)
Mississippi	None
Missouri	None
Montana	None
Nebraska	Rev. Stat. of Nebr. sec. 28-1401 et. seq. (1947) as amended (1969)
Nevada	None
New Hampshire	N.H. Rev. Stat. Ann. sec. 320.20 et. seq. (McKinney's 1954) as amended (McKinney's 1974)
New Jersey	N.J. Stat. Ann. sec. 45-17A-1 et. seq. (1971)
New Mexico	None
New York	N.Y. Social Serv. Law sec. 481 et. seq. (McKinney's 1954) as amended (McKinney's 1974)
North Carolina	Stat. of N.C. sec. 108-67 et. seq. (1969) as amended (1973)
North Dakota	N.D. Cent. Code sec. 108-67 et. seq. (1969) as amended (1973)
Ohio	Ohio Rev. Code Ann. sec. 1716.01 et. seq. (1967)
Oklahoma	Okla. Stat. Ann. tit. 18, sec. 552.1 et. seq. (1959)
Oregon	Ore. Rev. Stat. sec. 128.805 - 128.845 (1971)
Pennsylvania	Pa. Stat. Ann. tit. 10 sec. 160.1 et. seq. (1963) as amended (1972)
Rhode Island	None
South Carolina	S.C. Code Ann. sec. 67-91 et. seq. (1972)
South Dakota	None
Tennessee	Tenn. Code Ann. sec. 62-1501 et. seq. (1961) as amended (1963)
Texas	None
Utah	None
Vermont	None
Virginia	Va. Code Ann. sec. 57-40 et. seq. (1948) superceded by sec. 57-48 et. seq. (effective 1975)
Washington	Wash. Rev. Code Ann. ch. 19.09 (1974)
West Virginia	None
Wisconsin	Wis. Stat. Ann. sec. 440-41 (1967) as amended (1970)
Wyoming	None

Table 9

Charitable Solicitations - State Laws Regulating the Solicitation of Funds for Charitable Purposes
(As of August 1974)

By Charitable Organizations							By Professional Fund Raising Counsel and Solicitors		
State	Regulatory Agency/Enf. Officer	Subpoena Power	Registration or Licensing	Form of Annual Report and Due Date	Cost Limits	Penalties	Registration or Licensing	Surety Bond	Period for Filing Contracts
Arkansas	Sec. of St./ Pros. Att.		Reg.	Within 90 days after close of calendar or fiscal year		$500 &/or 6 mo.-INJ.	Reg.	$5,000	None, but K must be kept for 3 years.
California	None (solicitations fraud statute)					Perjury	License (display card)		
Connecticut	Welfare Dept./ Pros. Att.	Records	Reg.	On form prescribed by Dept. within 3 mo. after close of fiscal year.	15% to prof.	$1000 &/or 1 yr.-INJ.	Reg.	$10,000	Within 10 days
Florida	Sec. of St./ Pros. Att.		Reg.	Within 6 mo. after close of fiscal yr. per accounting principals and on reporting forms consistent with Natl. Hl. Council-NSWA Uniform Reporting Standards & Forms		1) $500 &/or 6 mo. 2) $1000 &/or 1 yr.	Reg.	$10,000	Prior to beginning of any solicitation by prof. solic.
Georgia	Sec. of St./ Att. Gen.		Reg.	Per Dept. forms by March 31 or within 90 days after close of fiscal yr.			Reg.	$5,000	None, but K must be kept for 3 yrs.
Hawaii	Dir. of Regulatory Agencies of the State.	Records	Reg.	For previous fiscal yr. with registration statement on forms prescribed by Director	10%	1) $500 &/or 6 mo. 2) $1000 &/or 1 yr. INJ.	Reg.	$5,000	Within 10 days

Table 9 (Continued)

By Charitable Organizations							By Professional Fund Raising Counsel and Solicitors		
State	Regulatory Agency/Enf. Officer	Subpoena Power	Registration or Licensing	Form of Annual Report and Due Date	Cost Limits	Penalties	Registration or Licensing	Surety Bond	Period for Filing Contracts
Illinois	Att. Gen.	Records and Witness	Reg.	Within 6 mo. after close of fiscal yr. on reporting forms revised by Att. Gen. on 1/1/68, per NHC-NSWA standards and forms	25%	$1000 &/or 1 yr.-INJ.	Reg.	$5,000	With reg. statement or within 10 days after execution
Iowa	Sec. of St./ Att. Gen. & Pros. Att.		Lic.	During mo. of Dec. in form prescribed by statute			Lic.	$1,000	
Kansas	Sec. of St./ Att. Gen.	Records and Witness	Reg.	On or before June 30 on form prescribed by Sec. of St.	25%	Misd. INJ.	Reg.	$5,000	Within 10 days
Kentucky	None (simple licensing statute)		Lic.						
Maine	Health & Welfare Dept./ Att. Gen.	Records and Witness	Lic.		30% (no lim. if % to solic. is made public)	$500 &/or 11 mo.	Lic.		
Maryland	Sec. of St.		Reg.	Within 90 days after close of fiscal yr. on forms prescribed by statute	subject to regulation	$500 &/or 6 mo.	Lic.		Within 10 days
Massachusetts	Div. of Pub. Charities of Dept. of Att. Gen./Att. Gen. or Dist. Att.	Records	Reg.	On or before June 1 or before 60 days following a fiscal yr. ending in April or May on forms prescribed by Div.	15% (pub. sol.) 50% (expenses)	$1000 &/or 1 yr.	Reg.	$10,000	Within 10 days

Table 9 (Continued)

By Charitable Organizations							By Professional Fund Raising Counsel and Solicitors		
State	Regulatory Agency/Enf. Officer	Subpoena Power	Registration or Licensing	Form of Annual Report and Due Date	Cost Limits	Penalties	Registration or Licensing	Surety Bond	Period for Filing Contracts
Michigan	Dept. of Social Welfare		Lic.	With application for license per instructions and forms similar to NHC-NSWA		$500 or 6 mo.			
Minnesota	Sec. of St.	Records and Witness	Reg.	On or before June 30 or 6 mo. after end of fiscal yr. on forms adopted by Sec.	30%	Misd.	Lic.	up to $20,000	
Nebraska	Sec. of St.		Lic. (from Cty. Att.)	6 mo. after end of calendar yr. on forms in compliance with NHC-NSWA		$1000			
New Hampshire	Dir. of Div. of Welfare		Lic.		15%	$25 or 6 mo.	Lic.		
New Jersey	Div. of Consumer Affairs of Office of Att. Gen.		Reg.	Within 6 mo. after close of fiscal yr. per standards prescribed by Att. Gen.	15% (prof. solic.) 50% (mail solic.)		Reg.	$10,000	Within 10 days
New York	Board of Soc. Welfare/Att. Gen.	Records	Reg.	Within 6 mo. of close of fiscal yr. per uniform standards prescribed by the Board	50% (mail solic.)	Misd. INJ.	Reg.	$5,000	Within 10 days
North Carolina	Dept. of Social Services		Lic.	Within 120 days after end of fiscal yr. on forms adopted by Dept.		$500 &/or 6 mo. - also fel.			

Table 9 (Continued)

By Charitable Organizations							By Professional Fund Raising Counsel and Solicitors		
State	Regulatory Agency/Enf. Officer	Subpoena Power	Registration or Licensing	Form of Annual Report and Due Date	Cost Limits	Penalties	Registration or Licensing	Surety Bond	Period for Filing Contracts
North Dakota	Sec. of St./ Att. Gen.		Lic.	Within 60 days after close of calendar or fiscal yr. on forms provided by Sec. of St.		$1000 &/or 6 mo.			
Ohio	Att. Gen.		Reg.	By March 31 or within 90 days after close of fiscal yr. on forms almost identical to NHC-NSWA		$500 &/or 6 mo.	Reg.	$5,000	None, but K must be kept for 3 yrs.
Oklahoma	Commissioner of Charities & Corrections/ Att. Gen. or Cty. Att.		Reg.	By March 31 or within 90 days after close of fiscal yr.		$500 &/or 1 yr. - also fel. ($10,000 &/or 10 yrs.) INJ.	Reg.	$2,500	With registration and at all time thereafter
Oregon	Att. Gen.		Reg.	Within 4 mo. and 15 days after close of calendar or fiscal yr.		$250 or 5 yrs. INJ.			
Pennsylvania	Dept. of SAT./Att. Gen. or Dist. Attn.	Records	Reg.	With registration statement as per NHC-NSWA standards & forms	15% (prof. solic.) 35% (expen)	1) $500 &/ or 6 mo. 2) $1000 &/or 1 yr.	Reg.	$10,000	Within 10 days

Table 9 (Continued)

	By Charitable Organizations						By Professional Fund Raising Counsel and Solicitors		
State	Regulatory Agency/Enf. Officer	Subpoena Power	Registration or Licensing	Form of Annual Report and Due Date	Cost Limits	Penalties	Registration or Licensing	Surety Bond	Period for Filing Contracts
South Carolina	Dept. of St./ Attn. Gen.	Records	Reg.	W/in 6 mo. after close of fiscal yr. per NHC-NSWA standards & forms	Reasonable % to Prof. Solic.	1) $100 &/or 1 mo. 2) $1,000 &/or 1 yr. INJ.	Reg.	$5,000	
Tennessee	Sec. of St.		Reg.	By July 31 on forms made available by Sec. of St.	15%	Misd.	Reg.		With annual report
Utah	None (solicitation fraud statute)					Misd.			
Virginia	Administrator of Consumer Affairs/ Att. Gen. or Commonwealth Att.	Records	Reg.		15%	1) $500 &/or 6 mo. 2) $1000 &/or 1 yr.	Reg.	$5,000	Within 10 days
Wisconsin	Dept. of Regulation & Licensing/ Att. Gen.		Reg.	Within 3 mo. after close of calendar or fiscal yr. on forms prescribed by Dept.	25%	INJ	Reg.	$5,000	None, but K must be kept for 3 yrs.
Washington	Dept. of Motor Vehicles/Att. Gen. & Pros. Att.	Records and Witnesses	Reg.	Within 90 days after close of fiscal yr. on uniform reporting forms provided by Dept.	20% (direct gifts) 55% (sale & benefit affairs)	INJ.	Reg.	$5,000	

Note: This table is an expanded and updated version of a table prepared under the auspices of the Council of Better Business Bureaus and the National Foundations/March of Dimes for the Ad Hoc Committee to Review State Legislation of the National Health Council. The initial table was prepared by Helen O'Rourke and John J. O'Connor.

Table 10

Agencies with the Authority to Regulate Charitable Solicitations and Fund Raising (As of November 1973)

	Attorney General	Other Agency
Alabama		
Alaska	Yes (If Fraud)	No
Arizona	Yes	No
Arkansas	No	Yes (Secretary of State)
California	No	No (Cities and Local Government)
Colorado	No	Yes (Dist. Attys. & Law Enforce. Agencies)
Connecticut		
Delaware	Yes	No
Florida	No	Yes (Department of State)
Georgia	No*	Yes (Secretary of State)
Hawaii	No*	Yes (Dept. of Regulatory Agencies)
Idaho	No	No
Illinois	Yes	No
Indiana	No	Yes (Cities and Local Government)
Iowa	No*	Yes (Secretary of State)
Kansas	No*	Yes (Secretary of State)
Kentucky	No	No
Louisiana		
Maine	No*	Yes (Department of Health & Welfare)
Maryland	No	Yes (Secretary of State)
Massachusetts	Yes	
Michigan	Yes	
Minnesota	No*	Yes (Department of Commerce)
Mississippi	No	No
Missouri	No	No
Montana		
Nebraska	No	Yes (Secretary of State)
Nevada	No	No
New Hampshire	No	Yes (Division of Welfare)
New Jersey	Yes	No
New Mexico	No	No
New York	No*	Yes (Department of Social Services)
North Carolina	No*	Yes (Dept. of Human Res., Dir. of Soc. Ser.)
North Dakota	No*	Yes (Secretary of State)
Ohio	Yes	No
Oklahoma	No*	Yes (Comm. of Charities and Corrections)
Oregon	Yes	
Pennsylvania	No*	Yes (Comm. on Charitable Org., Sec. of St.)
Rhode Island	No	No
South Carolina	No*	Yes (Comm. on Charitable Org., Sec. of St.)
South Dakota	No	No
Tennessee	No	No
Texas	No	No
Utah	No	No
Vermont	No	No
Virginia	No*	Yes (State Corporation Commission)
Washington	No*	Yes (Dept. of M.V.-Div. of Prof. Lic.)
West Virginia	No	No
Wisconsin	No*	Yes (Dept. of Regulation & Licensing)
Wyoming	No	No

*Enforcement authority would rest with the Attorney General.

Table 11

Number of Personnel in the Attorney General's Office Assigned to the Regulation of Fund Raising (As of November 1973)

	Attorneys	Accountants	Other
Alabama			
Alaska	None		
Arizona	None		
Arkansas	None		
California	None	None	None
Colorado			
Connecticut			
Delaware	1 PT	None	None
Florida	None		
Georgia	2 PT	None	None
Hawaii	None	None	None
Idaho	1 PT	None	None
Illinois	1 FT + 25% of staff's time assigned to Charitable Trust and Foundations		
Indiana	None	None	None
Iowa	None	None	None
Kansas	None	None	None
Kentucky	None	None	None
Louisiana	None	None	None
Maine	None	None	None
Maryland	1 PT	None	None
Massachusetts	4 FT (also charged with charitable trusts)		2 Law Clerks
Michigan	6 FT; 2 PT	1 FT	3 PT Investigators
Minnesota	2 PT	None	1 Registrar
Mississippi	None	None	None
Missouri	None	None	None
Montana			
Nebraska	None	None	None
Nevada	None	None	None
New Hampshire	2 PT	None	None
New Jersey	1 PT	1 PT	1 FT Investigator
New Mexico			
New York	5 FT		
North Carolina	3 FT	1 FT	
North Dakota	Handled on a need basis		
Ohio	3 FT	1 FT	1 Legal Aide
Oklahoma	None	None	None
Oregon	1 FT; 2 PT		1 Registrar; 1 Investigator; Dir.
Pennsylvania	None	None	3 Law Clerks
Rhode Island	None	None	None
South Carolina	1 PT	None	None
South Dakota			
Tennessee	None	None	None
Texas	None	None	None
Utah	1 PT		
Vermont	None	None	None
Virginia	Division of Consumer Affairs		
Washington	1 PT	None	None
West Virginia			
Wisconsin	1 PT		1 PT Investigator
Wyoming	None	None	None

foundations which are not essentially transient in nature, these professional fund raisers have the capability of moving across state lines with relative ease. Because the presence of the professional fund raiser may be completely unknown throughout the entire solicitation appeal, the registration or reporting requirement is necessary.

Virtually all state statutes, as shown in Table 9, require that charitable organizations, professional fund raisers and fund raising counsel register with the regulatory agency. (A professional fund raiser being defined as an individual or organization which actively engages in a solicitation campaign. Such person or organization may or may not take a percentage of the gross amount solicited. As a rule, a professional fund raising counsel does not personally engage in a solicitation appeal, but rather counsels and advises the members of the charity. A professional solicitor is most often defined statutorily as an employee or agent of a professional fund raiser as that term is used in its generic sense covering both professional fund raisers and fund raising counsel.) As a general rule, the registration statement is valid for a period of one year. The information sought includes the name and address of the principal charity and the professional fund raiser, the nature and purpose of the solicitation, the proposed budget and the expected contribution goal. Some states (California, Florida, Hawaii, Iowa, Maine, Maryland, Michigan, Minnesota. New Hampshire, North Carolina, North Dakota, Pennsylvania, and Washington) issue a registration certificate or permit to the professional fund raiser.

Periodic reporting requirements for the most part are imposed upon the charitable entity rather than the professional fund raiser. Such an accounting by the charity provides the ncessary financial information concerning the results of a solicitation appeal. Most of the state statutes require that annual financial reports be filed. Several states, however, do impose reporting requirements directly upon the professional fund raiser. These states include: Minnesota, Ohio, Oregon, Washington, and Wisconsin.

Only 17 of the 31 state statutes impose any cost limitation on the professional fund raiser or solicitor and only 14 out of the 17 impose a precise percentage limitation. Fourteen states require the filing of all contracts between the charity and the professional fund raiser or solicitor, and 25 states require that the professional fund raiser and solicitor be either registered or licensed.

In addition to registration and reporting requirements, 21 states impose a bonding requirement on either the professional solicitor, or the professional fund raiser, or both. The monetary amount of the bond ranges from $1,000 (in Iowa) to an amount not to exceed $20,000 (in Minnesota).

In terms of investigative capabilities, only 12 of the state solicitation statutes grant subpoena power. Also, with the exception of North Carolina and Oklahoma, where violation of the statute can result in a felony prosecution, the states impose only misdemeanor penalties for a violation.

In order to ascertain the amount of enforcement activity in the area of charitable solicitations, each attorney general was asked to indicate the amount of cases litigated during the calendar year of 1973 and the first six months of 1974. Only six states indicated involvement in litigation during the time period. These states are Kansas, Massachusetts, Michigan, Ohio, Pennsylvania, and Wisconsin. This finding must, or course, be balanced against the fact that only nine states recognize the attorney general as the formal regulatory body. In addition, 15 states place enforcement authority in the attorney general although he is not the formal regulatory agency. These are the so-called split function states. Four of the six states indicating participation in litigation fall into the split-function category: Kansas, Minnesota, Pennsylvania, and Wisconsin.

A corollary aspect of the attorney general's regulation of charitable solicitations is providing information to the public about charitable fund raisers. In those states that require registration by professional fund raisers, there is a readily available source of public information. To a lesser extent it is also a source of information for charitable organizations that desire to have a professional fund raiser direct a contribution campaign.

Of the 29 states which report the existence of a registration or licensing requirement, each makes the information on file available to the public upon request. In addition, three states make periodic news releases concerning operating or newly registered charitable solicitors. These states are: New Hampshire, North Carolina, and Pennsylvania. Wisconsin publishes a directory which contains a listing of charitable solicitors.

As a result of the survey, it would appear that the state attorneys general are not nearly as active in the area of charitable solicitations as they are in the area of charitable trusts and foundations. This appears to be attributable to the absence of a clear historical basis for his functioning in this area and as a result of the statutory vesting of authority in other state agencies.

Several points can be made about the charitable solicitation statutes. First, it is highly doubtful that those states that do not require the filing of an annual report can effectively regulate solicitations. Mere registration or licensing is not sufficient in the absence of reports which enable the regulatory agency to monitor the financial activities of the soliciting organization on a continuous basis. Additionally, it should be noted that effective regulation is difficult in the absence of a provision granting subpoena powers to the regulatory agency.

Finally, many of the statutes require reporting to one state agency and enforcement by another. While this arrangement may work in some instances, it is certainly possible that effective administration is retarded. While the attorney general may not be recognized as the regulatory agency *per se*, he often retains enforcement authority. This split-function situation which exists in a number of states does not appear to have any weakening effect upon the overall regulatory operation. It must be noted, however, that the data base in this area is exceptionally weak because only six states report any letigation in the area at all. While the solicitations field is in its relative infancy in comparison with charitable trusts and foundations, the developing trend is inescapable. The problem, however, is that which also exists to some extent in the charitable trusts area: a greater public awareness is needed. It will be indeed unfortunate if we must wait for large abuses to occur before legislation is enacted.

Analysis of The Model Solicitations Act and Proposed Revisions

In October 1973 the Ad Hoc Committee to Review State Legislation of the National Health Council issued a draft of "Model Legislation Regulating Charitable Organizations."[62] The proposed legislation was formally entitled "An Act to Regulate Individuals and Organizations Engaged in Charitable Public Solicitation" and was modeled after state statutes in New York, Wisconsin, Nebraska, Pennsylvania, Massachusetts, and Ohio. Its primary aims were (1) to provide guidance for state legislators and regulators in those states where little or no legislation existed and (2) to supplant existing legislation which had not satisfactorily accomplished its original purpose of providing the state regulatory agency with an efficient and comprehensive means of supervising charitable solicitations.

While the act was patterned after existing legislation, there is a departure in several important respects. The principal components of the act provide for standard definitions, registration and reporting by charitable organizations and professional fund raisers, exemptions from registration and reporting, the creation of a Commission on Charitable Organizations, prohibited acts and enforcement.

The act in section 2 attempts to clarify the scope of its coverage by a definition of terms. For example, the term "charitable organization" is defined as

> A person which is or holds itself out to be a benevolent, educational, philanthropic, humane, patriotic or eleemosynary organization or any person which solicits or obtains contributions solicited from the public for charitable purposes after the effective date of this act. A chapter, branch, area, office or a similar affiliate or any person soliciting contributions within the State for a charitable organization which has its principal place of business outside the State shall be a charitable organization for the purposes of this act.

The term person is then defined to include individuals, corporations, partnerships, and practically any other type of association. It does not include those authorized persons who solicit on behalf of a registered or exempt charitable organization. Such individuals or organization would be classified as professional fund raisers or solicitors, who are defined elsewhere in the act. The above definition would appear to be all-inclusive and cover almost every conceivable organization that solicits charitable funds.

Another definition thought to be clarified is that of a professional fund raiser. For some time there has been a dispute within the professional fund raising community as to the proper definition of a professional fund raiser. The disagreement centers more on the standard of ethical conduct displayed by certain individuals rather than a workable legal definition. The principal argument is that a fund raiser who receives, as a fee, a majority of the funds contributed, should not be entitled professional in any sense of the word. The model act simply states in section 2.8 that a professional fund raiser is

> . . .any person who for compensation or other consideration plans, conducts, manages, carries on or advises concerning any drive or campaign in this state for the purpose of soliciting contributions for or on behalf of any charitable organization, or who engages in the business of, or holds himself out to persons in this state as independently engaged in the business of soliciting contributions for such purpose. A bona fide officer or employee of a charitable organization or of a registered professional fund raiser, shall not be deemed a professional fund raiser.

This definition also overcomes the distinction between a professional fund raiser and a professional fund raising counsel as those two terms have been used within the industry. According to one definitional distinction, the professional fund raiser personally engages in the solicitation of funds while the professional fund raising counsel gives advice and counsel to the charitable organization whose members actually perform the solicitation. Additionally, a professional fund raising counsel, according to the American Association of Fund-Raising Counsel, cannot base his fee upon a percentage of the gross amount solicited, while a professional fund raiser may do so. The approach correctly taken by the model act is to disregard this distinction by combining them under one legal heading concerning all professional fund raisers. Thereafter, both types would have to comply with the registration requirements for such individuals and organizations found in section 11 of the model act.

Another definitional distinction which has troubled the fund-raising community and one which is also clarified by the model act is the difference between a professional fund raiser and a professional solicitor. In several instances the state statutes which distinguish between these individuals and impose varying statutory requirements (insofar as bonding and registration requirements are concerned) are extremely vague and poorly drafted. Under the model act a professional solicitor is defined as ". . .any person who is employed or retained for compensation by a professional fund raiser to solicit contributions for charitable purposes in this state, but shall not include any officer or employee of a charitable organization or of a registered professional fund raiser whose duties to raise funds are incidental to his regular employment." This seems to be a workable definition which should eliminate the difficulties encountered.

Typical of all existing charitable solicitation legislation is a statutory exemption section which excludes certain organizations from the registration and reporting requirements of the statute and thereby from the coverage of the act. In this respect the model act does not alter the existing law. It provides in section 5 an exemption from these registration and reporting requirements for five types of organizations or individuals. Organizations exempted are religious organizations and their affiliates (an exemption which will be discussed later), educational institutions, nonprofit hospitals, charitable organizations that solicit among their own membership and persons who solicit contributions for a named individual if the named individual receives all of the contributions (without any deductions). It should be noted that in terms of an exemption for organizations soliciting among their own membership, that membership shall not be determined by the fact that the individual has made a contribution.

Without question, the greatest departure from existing statutes found in the model act is the creation of a Commission on Charitable Organizations. The commission is to consist of the secretary of state and six citizens of the state, none of whom may be a state employee. They shall be representative of the public solicited and of the various categories of charitable persons for whom solicitations are made. At least one of the members shall be a representative of an independent charitable organization not affiliated with a federated fund raising organization. A federated fund raising organization is defined as federation of independent charitable organizations which have voluntarily joined together for purposes of raising and distributing money for and among themselves. The commission has rule-making and adjudicative powers and is to publish an annual report analyzing the effectiveness of its regulations and the activities of persons subject to the act.

It has been repeatedly pointed out that registration and reporting requirements are the crux of any regulatory scheme for both charitable trusts and foundations and charitable solicitations. The model act retains those requirements in sections 4 and 11. They impose registration requirements before a charitable solicitation may be commenced. Under section 4, registration is completed by filing a registration statement with the secretary of state on a form prescribed by him. (It has been recommended that each time a reference is made to the secretary of state, the phrase "appropriate state agency" be substituted. It is our understanding that the model act committee has no preference as to which state authority ought to regulate this conduct.) The statement is filed in the first year a solicitation takes place and in each succeeding year during which the organization engages in such activities. The information required includes basic information such as the name and address of the organization, the purpose of the organization, the name and address of branches, affiliates, or chapters, the date, place, and form of organization, a reference to any determination of tax-exempt status, financial statements for the previous year, whether the organization intends to solicit from the public directly or have the solicitation performed on its behalf by others, and a listing of the salaried executive staff. The model act will presumably preserve forms currently utilized by regulatory agencies. In those states that have yet to adopt charitable solicitation legislation, the model act registration requirements provide an excellent basis for information gathering.

Section 11 of the model act provides for the registration of professional fund raisers and professional solicitors. These two classes of individuals or organizations are also required to file a registration statement with the secretary of state. The registration application of every professional fund raiser must be accompanied by the filing of a bond in the amount of $5,000. The professional fund raiser as the principal organization would be required to file a bond while the professional solicitor would not, but both types of individuals must register independently. The provision of the model act which does not require the independent bonding of professional solicitors represents a departure from existing statutory provisions in several jurisdictions.[64]

The registration statement filed by the professional fund raiser or solicitor is valid for a renewable period of one year, which is typical of most charitable solicitation statutes. Of note is the language providing for an appeal to the Commission on Charitable Organizations upon the denial of a registration. There is no similar provision in any existing charitable solicitation legislation.

In addition to registration requirements, the model act provides in section 6 for the filing of annual reports by all charitable organizations subject to the act. Neither a professional fund raiser or solicitor is subject to the annual reporting provision. All charitable organizations that employ a professional fund raiser or receive contributions in excess of $5,000 are required to file financial statements accompanied by an opinion signed by an independent public accountant. An organization exempt from filing can secure its exempt status by filing an affidavit setting forth the reasons for such exemption.

Another important provision contained in the model act with regard to the annual reporting is the adoption in section 6 of uniform accounting procedures. Perhaps one of the most neglected areas in the overall regulation of charitable organizations and nonprofit corporations is the failure to have accounting procedures that conform to generally accepted accounting principles. The adoption of such procedures would make the reporting form far more comprehensible within the charitable organization community and to the regulatory agency. Without the adoption of such procedures the regulatory agency must repeatedly request additional information from the charitable organization.

In addition to those sections which have been selected for individual discussion, the model act contains a number of other sections which should be noted before a discussion of contemplated revisions can proceed. One of these sections (section 7) concerns the limitation on the amount of compensation to be paid to a professional fund raiser or solicitor. The model act adopts the position that no more than a reasonable percentage should be paid exclusive of cost of goods or services provided to the public. This will be discussed in detail later.

Another section worthy of note is section 8, which provides for the recording of contracts (with the secretary of state) between a professional fund raiser and the charitable organization. This is an adoption of the procedures already found in many charitable solicitation statutes. These contracts and all other documents including the registration statement and the annual reports are open to public inspection (section 9).

Prohibited acts and enforcement provisions of the model act are found in sections 13 and 15 respectively. Section 13 prohibits 1) using or exploiting the fact of registration to imply the charity is endorsed by the state, 2) misleading the public into believing a contribution is for a charitable purpose when it is not, 3) stating or implying that any named person sponsors, endorses, or approves of a charity or charitable purpose without that person having given written consent to the use of his name, 4) soliciting contributions on behalf of a charitable organization without authorization.

Section 15 of the model act deals with enforcement and penalties. The secretary of state has the power to revoke the registration of any charitable organization, professional fund raiser or professional solicitor who has knowingly made a false or misleading statement in any registration application or statement. Likewise he has the discretion to suspend or revoke a registration if the application contains false or misleading statements, or if a registrant has violated the provisions of the act.

Additionally, he has investigative powers if there are reasonable grounds to suspect a violation. The willful and intentional giving of false or incorrect information is a misdemeanor punishable by fine of not less than $100 and/or imprisonment. The secretary of state may request the attorney general to bring suit for injunction and/or other relief against charitable organizations, professional fund raisers, or professional solicitors for failure to file required statements or reports, or for violations of the other provisions of the model act.

From a regulatory viewpoint there are a number of problems presented by the model act, which could be rectified by revisions in four basic areas. The revisions, which will be discussed in detail, concern (1) fund-raising-costs limitations, (2) the proposed Commission on Charitable Organizations, (3) state approval of contracts between the professional fund raiser and the charitable organization, and (4) the exemption of religious organizations from registration and reporting requirements.

Because high solicitation expenses can be incurred due to inefficiency, out-right fraud or an unwise choice of the solicitation method, it is necessary to monitor and regulate these costs. From a regulatory viewpoint, it is essential that the maximum use be made of the charitable dollar because (1) that is what the donor expects, and (2) integrity of the whole solicitation process is at stake.

Several methods are available to limit the occurrence of a solicitation campaign in which expenses absorb an inordinately large part of the funds received. One approach is to require disclosure of these expenses. A disclosure statement is probably less burdensome to a professional fund raiser or charitable organization since it places no restrictions on the amount of costs that can be incurred. The burden is on the public to determine whether or not efficient use has been made of the charitable dollar. The major drawback to this approach is that too much reliance is placed on the public's ability to determine whether or not their donation will ultimately reach the charity.

Another method which can be used to limit or prevent the occurrence of excessive solicitation expenses is to impose an absolute percentage limitation on the amount that can be expended for solicitation expenses. Several states have statutes with such provisions (see Table 9). Advantages of this method are that it is uniform, it gives fair notice of what is permissible, and the public is assured that a certain amount of their donation will be utilized for charitable purposes.

There are also some distinct disadvantages, foremost of which is inflexibility. For example, since such a statute absolutely prohibits costs in excess of a certain percentage, it will not recognize situations where the costs do not exceed the limitation but are truly "excessive." Conversely, by fixing a percentage, it may encourage the expenditure of funds up to that amount which otherwise may not have been expended.

Another aspect of fixed percentage limitation involves restrictions on amounts used to purchase goods for eventual sale to the public. The State of Washington has adopted such a statute limiting the amount that can be paid to those providing goods and/or services to the donor. The limit is 55 percent. However, this can be exceeded if the appropriate authority believes that the excess is due to special reasons and the solicitation costs are reasonable. Washington Rev. Code Ann. 19.09.100 (1974).

The model act provides yet another method for regulating fund-raising costs. The standard adopted is "a reasonable percentage." This standard can be defined by the Commission on Charitable Organizations (section 3 of the model act). It is enforced by the appropriate state agency through its power to disapprove contracts or written statements between a professional solicitor and a charitable organization (section 8 of the model act), or through the enforcement and penalty provisions of section 15 of the model act.

Since the standard is "a reasonable percentage," it apparently was not necessary to set a different standard when goods are involved. The standard is broad enough to implicitly cover such a situation.

A reasonable cost concept has much appeal because of its flexibility. It permits the regulatory agency to examine all fund raising costs on a case-by-case basis as well as giving a charitable organization some latitude in expending funds for fund-raising purposes.

One alternative to the above is an approach combining the beneficial aspects of both a fixed percentage and a reasonable percentage standard. When fund-raising costs are below a fixed percentage the burden of proof would be on the regulatory agency to show unreasonableness. When that limit is exceeded, the charitable organization assumes the burden of proving reasonableness. This approach has the advantage of a case-by-case determination, set guidelines, and flexibility.

Some states have adopted similar legislation by providing that solicitation and fund-raising costs above a fixed percentage are *prima facie* unreasonable.[65] The burden of proof is shifted to the fund-raising organization to show that the additional costs were warranted. However, the revised approach goes one step further by providing that the regulatory agency can challenge fund-raising costs below a fixed percentage where it is indicated that they were unnecessarily incurred.

Another topic which has received considerable discussion is the proposed creation of a Commission on Charitable Organizations. The function of the commission is to make rules and regulations concerning charitable solicitations and to hold hearings on appeals regarding the revocation or suspension of a license or the refusal of a license application.

As stated earlier, the commission is to be composed of the secretary of state (or alternate state agency, such as the attorney general) and six or more citizen members, who are to serve without pay. The citizens are to be representatives of the public and of soliciting charitable organizations, with at least one member being a representative of an independent charitable organization not affiliated with a federated fund-raising organization.

A number of problems are readily apparent when you compare the commission with an alternate proposal known as the Charitable Solicitation Board of Review. The composition of this board of review would differ significantly from the composition of the commission. The board would be composed of three members, all of whom must be experienced in the charitable solicitations area. At least one member would be an attorney, one would be from the government sector, and one would be from an organization covered by the model act. Each member of the board would serve full time, and no more than two of the three members would be from the same political party. It should be required that all the members possess some level of competence to enable them to deal with the issues which will be presented to them. Furthermore, the board would be set up as an independent agency apart from the regulatory agency. In contrast, the commission membership includes the head of the enforcement agency. Under the model act's approach the same person who decides that a registration should be revoked or canceled also has the reponsibility of reviewing that decision. It is obvious that this type of review is inherently unfair.

Alternate reviewing procedures are also being proposed. Any person whose registration was rejected, revoked, or modified by the enforcement authority would appeal to the board. A *de novo* hearing would be held after which a decision would be rendered. The decision of the board may be appealed to the court of appeals of the county in which the state capital is located. The appeals court would reach its decision based on the record and would affirm the order of the board if it is supported by reliable, probative, and substantial evidence.

Before the Model Solicitations Act is submitted by the Ad Hoc Committee to the legislatures of the several states for enactment, it is also necessary that a careful study be undertaken in order to determine whether the act, as presently drafted, may be subject to challenge on either federal or state constitutional grounds. The purpose of this segment of the report is to suggest and discuss in brief the possible constitutional deficiencies that may be contained in the act. For the sake of this discussion, it is sufficient to focus upon the federal constitution alone, since nearly all of the state constitutions substantially mirror the federal model.

Sections 8 and 15 of the model act are of primary concern, for they describe the procedures by which the secretary of state approves or disapproves contracts between professional fund raisers and charitable organizations, investigates possible violations of the act, and enforces the act by means of subjecting violators to a range of civil and criminal sanctions including misdemeanor penalties, injunction, cancellation, revocation, suspension or refusal of acceptance of a registration application. Of particular interest is section 8.2 which sets forth the standards by which the secretary of state is to judge contracts or agreements between fund raisers and charitable organizations:

> If the Secretary concludes that such a contract or written arrangement will involve an excessively high fund-raising cost, he shall request the parties to provide satisfactory explanation and may, if not satisfied, request renegotiation of the arrangement upon terms acceptable to him. In the event this is not done within ten days, the Secretary may disapprove the contract or arrangement. No registered charitable organization or professional solicitor shall carry out or execute a disapproved contact, or receive or perform services, or receive or make payments, pursuant to a disapproved contract. Any party to a disapproved contract shall, upon written request made within thirty days of disapproval, be given a hearing before the commission within thirty days after such a request if filed.

In analyzing the language of section 8.2, four possible issues of constitutional magnitude are revealed. In the order that they will be discussed below, the issues are as follows: (1) does the procedure described in section 8.2 violate procedural due process rights of the parties seeking approval of a solicitations contract or written arrangement, (2) is the statutory standard by which the secretary of state is supposed to judge the merits of solicitation contracts overly vague and without an intelligible principle so as to amount to an unconstitutional delegation of adjudicative power by the legislature to the secretary of state, (3) does the failure of section 8.2 to provide for judicial review of the decisions of either the secretary of state or the commission amount to a constitutional violation, (4) do the provisions of section 8.2 so impair the obligation of contracts between persons and organizations subject to the model act as to violate Article I, Section 10 of the United States Constitution (which provides "No State shall pass any. . .law impairing the obligation of contracts. . . .")?

Section 8.2 requires the secretary of state to determine if the contract under his consideration ". . .involves an excessively high fund raising cost." After such a determination, the secretary of state must necessarily request an explanation from the parties to the contract. At this point in the procedure set forth in section 8.2, the question arises as to whether the parties are entitled under the due process clause to a hearing rather than just an opportunity to make an informal explanation about the circumstances surrounding the contract under consideration. Since the secretary of state's determination seemingly rests upon an adjudicative decision-making process, denial of an opportunity to present opposing evidence and argument to such adjudication may amount to a denial of due process.[66] The principle underlying the need for a sufficient procedure in this context is that a party who has sufficient interest at stake in a determination of governmental action should be entitled to an opportunity to know and to meet, with the weapons of rebuttal evidence, cross-examination and argument, unfavorable evidence of adjudicative facts.[67]

Moreover, the possible deficiencies raised above in the context of the due process clause most likely are not cured by the provision in section 8.2 permitting the parties a hearing before a commission after an adverse decision by the secretary of state. It is clear that the requirements of due process must be met at the time of the initial adjudication that the contract is found to involve excessively high costs unless the commission is later empowered to review the entire matter *de novo.*[68] Thus, since section 8.2 does not describe the exact procedures under which either the secretary of state or the commission will operate, it is important to develop an administrative process under the model act to meet due process requirements.

The standard by which the secretary of state is supposed to judge fund-raising contracts is stated in section 8.2 and rests upon one major consideration: whether the contract involves an excessively high cost. For such a delegation of power to an administrative officer to be valid, the delegation must contain legislative standards which the officer must follow in his decision making.[69] If the standard is too vague and does not convey an intelligible principle, the legislative delegation is invalid.

Although the law of state delegation differs somewhat from the law of federal delegation, it is common to both the state and federal court decisions that there is much confusion about what standards are vague and what standards are not vague. Accordingly, though the standard contained in section 8.2 most likely meets all the delegation of power criteria, it may be wise to include in more detailed language the precise aspects of fund-raising contracts that the secretary of state should consider. Thus, any challenge to the act on this basis could be avoided.[70]

None of the provisions of the model act mention judicial review of administrative action taken by the secretary of state or the commission. While the state courts have apparently had little hesitation in cutting off judicial review of administrative determinations,[71] it is clear that where criminal penalties may arise from administrative adjudication, judicial review of such a determination is constitutionally required.[72] Although neither the secretary of state nor the commission is granted the power to impose criminal penalties by section 15.4, paragraph 2, the secretary is given the discretion to request the attorney general to bring an action in the name of the state against any charitable organization or fund raiser who the secretary believes has willfully violated the provisions of the model act.

Thus, it is the exercise of discretion on the part of the secretary of state which may directly lead to the imposition of criminal penalties upon charitable organizations or professional fund raisers. For this reason, a question arises as to whether the model act should provide for judicial review at some point in the administrative process in order to meet constitutional requirements. Since the exercise of the secretary's discretion to request the attorney general to bring a criminal action must be based upon an adjudicative, decision-making analysis of the facts before him in any given case, it would seem wise that the model act include a provision for judicial review to safeguard the constitutional rights of those persons subject to the act.[73]

The contract clause of the U.S. Constitution is found in Article I, Section 10, cl. 1. Although during the first century of government under the Constitution the prohibition of any state law impairing the obligation of contracts was a major restraint on state economic regulation, since the 1930s contract clause barriers have been substantially lowered.[74]

Regarding the model act, it is extremely doubtful whether the contract clause prohibits such regulation of charitable solicitations. First of all, it must be remembered that the clause is applicable when the state attempts to regulate the obligations of contracts, not when the state regulates the formation of contracts. Even if the act affects contractual obligations, the decisions put it beyond question that the states possess the authority to safeguard such a vital interest of their people as solicitations for charitable purposes.[75] The Supreme Court has succinctly stated the relation of state regulation to the contract clause and has thereby concluded that the clause does not remain a barrier to any reasonable public regulation:

> The States retain adequate power to protect the public health against maintenance of nuisances despite insistence upon existing contracts. . . .
>
> The policy of protecting contracts against impairments presupposes the maintenance of government by virtue of which contractual relations are worthwhile – a government which retains adequate authority to secure the peace and good order of society.[76]

Thus, to reiterate, there exists no real doubt that the model act easily clears the barrier of the contract clause. The act attempts to regulate an area of legitimate concern to the states and provides a reasonable scheme for such regulation.

The Religious Organization Issue

One of the major problems confronting the regulation of charitable solicitations drawn into focus by the Model Solicitations Act is the question of the permissible extent of state regulation over purely religious or religiously affiliated organizations that publicly solicit funds. The model act and most state solicitation statutes totally exempt such religious organizations from regulation even if the purposes for which the solicitation is performed are only peripherally religious.

Section 2 of the model act defines a "charitable organization" as follows:

> SECTION 2. Definitions. The following words and phrases as used in this act shall have the following meanings unless a different meaning is required by the context:
>
> 1. "Charitable organization". A person which is or holds itself out to be a benevolent, educational, philanthropic, humane, patriotic, or eleemosynary organization or any person which solicits or obtains contributions solicited from the public for charitable purposes after the effective date of this act. . .*This definition shall not be deemed to include any constituted religious organizations or any group affiliated with and forming an integral part of such organization no part of the net income of which inures to the direct benefit of any individual and which have received a declaration of current tax exempt status from the government of the United States.* . . . [emphasis added]

Section 5 of the model act which provides for the registration also specifically exempts religious organizations. Section 5 reads:

> SECTION 5. Exemptions.
>
> 1. The following shall not be required to file registration statements with the Secretary of State:
>
> a. A corporation sole or other religious corporation, trust or organization incorporated or established for religious purposes, nor any agency or organization incorporated or established for charitable, hospital, or educational purposes and engaged in effectuating one or more of such purposes, that is affiliated with, operated by, or supervised or controlled by a corporation sole or other religious corporation, trust or organization incorporated or established for religious purposes, nor other religious agencies or organizations which serve religion by the preservation of religious rights and freedom from persecution or prejudice or by fostering religion, including the moral and ethical aspects of a particular religious faith.

The above quoted language provides a very broad exemption which can be utilized by large numbers of organizations which merely claim to be "religious." The present exemption also covers subsidiary organizations or affiliates of organized religious groups. Such affiliates, while nominally controlled by a *bona fide* religious group, may be engaged in activities that are not primarily religious. An example of such a situation would be a hospital controlled by a religious denomination. The present language in the exemption clause is broad enough to cover any nominally religiously affiliated organization.

The present language also exempts from the registration requirement practically any group or organization claiming religious status. There should be a mechanism within the model act that allows a state official to scrutinize organizations claiming "religious" status and publicly soliciting funds. Of course any attempt to regulate the public solicitations of such organizations runs into the constitutionally protected right of freedom of religion. However, it should be possible to stay within constitutional bounds and yet gain basic information concerning religious organizations that solicit funds. The dividing line between permissible state regulation and a violation of constitutional rights rests in the administrative decision of whether to grant or reject a registration (or license) preliminary to soliciting funds. Where the administrative decision determines the basic worthiness of the religious cause or whether the organization is, per se, a religion, such a decision is constitutionally impermissible and becomes censorship of the free exercise of religion.[77]

It is clear, however, that a state possesses the general power to regulate solicitations through nondiscriminatory legislation relating to the manner of the solicitation.[78] Certainly the cloak of religion should not be permitted to commit outright fraud on the public.[79] Therefore, where the decision to grant or withhold a license does not depend on any religious test, state regulation should be valid in a constitutional sense.

Furthermore, where the public solicitation by religious organizations or their affiliates is not solely for the preservation or advancement of religion, the state may regulate that part of the solicitation which benefits a charitable rather than a religious purpose. The state as well as the church has an interest in the welfare of its citizens apart from any religious connotations, although many regard the practice of charity as a religious duty.[80]

In order to comply with the constitutional dictates and at the same time regulate public charitable solicitations, a number of revisions must be made to the religious exemptions portion of the model act and in similar state legislation. The proposed approach is essentially definitional. The coverage of the model act would be expanded to include religious groups and their affiliates by inserting the word "religious" into the definition of "charitable organizations" and then deleting language which now exempts religious groups. The statute would read:

> SECTION 2. Definitions.
>
> 1. "Charitable Organization" means: any benevolent, religious, educational, philanthropic, humane, patriotic, or eleemosynary organization or person which solicits or obtains contributions solicited from the public for charitable purposes. A chapter, branch, area office, or similar affiliate or any person soliciting contributions within the state for a charitable organization which has its principal place of business outside the state shall be considered a charitable organization for the purposes of this act.

If all religious groups are covered by the statute, the governmental agency which administers the statute can take the position that they are entitled to some initial information regarding a group's activities in order to determine whether or not the group should be exempted from the registration requirements. Without this coverage, the state agency would be prevented from examining activities of any group which labeled itself as a "religious" organization.

The proposal would retain the present intention that the model act cover large, national organizations which are located or headquartered outside the state. Further, there would be no reference to a declaration of current tax exempt status from the government of the United States in subsection 1 of section 2. Deletion of this reference allows the state official to consider the tax-exempt status as only a factor in determining if exemption from filing is appropriate. This allows the state official flexibility to inquire into the activities of a religious group even though such a group may have been granted exempt status.

In addition to altering the definition section and thereby the basic scope of the act, there are changes which must be made to the reporting and registration sections in order to reflect this expanded coverage. At the present time the model act in section 5 exempts religious organizations and their affiliates from any registration requirement. Since no determination will be made as to the initial worthiness of the religious cause, religious organizations which are soliciting from the public and not solely from their own membership would be required to file a registration statement pursuant to section 4 of the model act. The effect of this change would be to bring all religious groups that solicit funds from the public under the scrutiny of the model act.[81]

However, the exemption from filing annual reports is retained in the proposed revision to the model act. This is to effectuate a compromise between the religious community and the state regulatory agencies and further to indicate that there is no intention to bridge the constitutional gap between church and state. So long as the initial registration statement provides the basic information that charitable or religious purposes will be benefited by the solicitation, there is no additional need for further state intervention.

Despite the initial hesitancy to launch a state regulatory program in this area, it must be done if those organizations hiding behind the cloak of religious affiliations are to be prevented from further injuring the public. The aim of these proposed revisions is not to subject religious groups and organizations to any form of censorship of their causes. They are aimed at preventing those organizations that solicit for charitable as opposed to religious causes from avoiding the mandate of the act.

Appendix A

Selected Citations to Cases From Twenty-Three Jurisdictions Holding That the Attorney General Retains His Common Law Powers

State v. Karston, 208 Ark. 703, 187 S.W. 2d 327 (1945).

People v. Stratton, 25 Cal. 242 (1864).

Darling Apartment Co. v. Springer, 25 D. Ch. 420, 22 A. 2d 397 (1941).

State ex rel. Landis v. S.H. Kress & Co., 115 Fla. 189, 155 So. 823 (1934).

Howard v. Cook. 59 Idaho 391, 83 P. 2d 208 (1938).

Fergus v. Russel, 270 Ill. 304, 110 N.E. 130 (1915).

Johnson, Governor v. Attorney General, 291 Ky. 829, 165 S.W. 2d 820 (1942).

Withee v. Lane & Libby Fisheries Co., 120 Me. 121, 113 A. 22 (1921).

Commonwealth v. Kozlowsky, 238 Mass. 379, 131 N.E. 207 (1921).

State ex rel. Young v. Robinson, 101 Minn. 277, 112 N.W. 269 (1907).

State v. Missouri Public Service Commission, 352 Mo. 29, 175 S.W. 2d 857 (1943).

State ex rel. Ford v. Young, 54 Mont. 401, 170 P. 947 (1918).

Mundy v. McDonald, 216 Mich. 444, 185 N.W. 877 (1921).

Kennington-Saenger Theaters v. State, 196 Miss. 841, 18 So. 2d 483 (1944).

In re Equalization of Assessment of Gas Pipe Lines, 123 Neb. 259, 242 N.W. 609 (1932).

State ex rel. Fowler v. Moore, 46 Nev. 65, 207 P. 75 (1922).

Fletcher v. Merrimack County, 71 N.H. 96, 51 A. 271 (1901).

Alexander v. New Jersey Power and Light Co., 21 N.J. 373, 122 A. 2d 339 (1956).

People v. Miner, 2 Lans. 396 (N.Y. 1868).

State v. Hagan, 44 N.D. 306, 175 N.W. 372 (1919).

Gibson v. Kay, 68 Oreg. 589, 137 P. 864 (1914).

Commonwealth ex rel. Minerd v. Margiotti, 325 Pa. 17, 188 A. 524 (1936).

State v. Ehrlick, 65 W. Va. 700, 64 S.E. 935 (1909).

Appendix B

Selected Citations to Cases from Twenty-Eight Jurisdictions Recognizing the Attorney General's Common Law Power To Enforce Charities

ALABAMA	*Williams v. Pearson*, 38 Ala. 299 (1862); *State ex rel. Carmichael v. Bibb*, 234 Ala. 46, 173, So. 74 (1937); *Thurlow v. Berry*, 247 Ala. 631, 25 So. 2d 726 (1946).
ARKANSAS	*State ex rel. Attorney General v. Van Buren School District No. 42*, 191 Ark. 1096, 89 S.W. 2d 605 (1936).
CALIFORNIA	*People ex rel. Ellert v. Cogswell*, 113 Cal. 129, 45 P. 270 (1896); *In re Los Angeles County Pioneer Society*, 40 Cal. 2d 852, 257 P. 2d 1 (1953); *Brown v. Memorial National Home Foundation*, 162 C.A. 2d 513, 329 P. 2d 118 (1958); *Holt v. College of Osteopathic Physicians & Surgeons*, 61 Cal. 2d 750, 394 P. 2d 932 (1964).
COLORADO	*Ireland v. Jacobs*, 114 Colo. 168, 163 P. 2d 203 (1945).
CONNECTICUT	*Proprietors of White School House v. Post*, 31 Conn. 240 (1862); *Healy v. Loomis Institute*, 102 Conn. 410, 128 A. 774 (1925); *Averill v. Lewis*, 106 Conn. 582, 138 A. 815 (1927); *New York East Annual Conference of the Methodist Church v. Seymore*, 151 Conn. 517, 199 A. 2d 701 (1964).
DELAWARE	*State v. Griffith*, 2 Del. Ch. 392 (1847); *Trustees of New Castle Common v. Gordy*, 33 Del. Ch. 196, 91 A. 2d 135 (1952); *Carlile v. Delaware Trust Co.*, 34 Del. Ch. 133, 99 A. 2d 764 (1953).
FLORIDA	*State ex rel. Landis v. S.H. Kress & Co.*, 115 Fla. 189, 155 So. 823 (1934); *Jordon v. Landis*, 128 Fla. 604, 175 So. 241 (1937).

HAWAII	*Hite v. The Queens Hospital*, 36 Hawaii 250 (1942); *Midkiff v. Kobayoshi*, 507 P. 2d 724 (1973).
ILLINOIS	*Attorney General v. Illinois Agricultural College*, 85 Ill. 516 (1877); *Hunt v. Fowler*, 121 Ill. 269, 12 N.E. 331 (1887); *Attorney General v. Newberry Library*, 150 Ill. 229, 37 N.E. 236 (1894); *People ex rel. Smith v. Braucher*, 258 Ill. 604, 101 N.E. 944 (1913); *Stowell v. Prentiss*, 323 Ill. 309, 154 N.E. 120 (1926); *Barker v. Houberg*, 325 Ill. 538, 156 N.E. 506 (1927); *McGee v. Vandeventer*, 326 Ill. 425, 158 N.E. 127 (1927); *Kerner v. Thompson*, 365 Ill. 149, 6 N.E. 2d 131 (1937); *People ex rel. Courtney v. Wilson*, 327 Ill. App. 231, 63 N.E. 2d 794 (1945).
INDIANA	*State ex rel. Emmert v. Union Trust Co.*, 74 N.E. 2d 833 (Ind. Ct. App. 1947), rev'd. on other grounds 227 Ind. 571, 86 N.E. 2d 450 (1949); *Boice v. Mallers*, 121 Ind. App. 210, 96 N.E. 2d 342 (1951).
IOWA	*In re Owen's Estate*, 244 Iowa 533, 57 N.E. 2d 193 (1953).
KANSAS	*Trautman v. DeBoissiere Odd Fellows Orphans' Home and Industrial School Association*, 66 Kan 1, 71 P. 286 (1903); *State ex rel. Londerholm v. Anderson*, 195 Kan. 649, 408 P. 2d 864 (1965).
KENTUCKY	*Chambers v. Baptist Educational Society*, 40 Ky. (1 B. Mon.) 215 (1841); *Attorney General v. Wallace*, 46 Ky. (7 B. Mon.) 611 (1847); *Jenkins v. Berry*, 119 Ky. 350, 83 S.W. 594 (1904); *Greenway v. Irvine*, 279 Ky. 632, 131 S.W. 2d 705 (1939); *Commonwealth ex rel. Ferguson v. Gardner*, 327 S.W. 2d 947 (Ky. Ct. App. 1959).
MASSACHUSETTS	*Going v. Emery*, 33 Mass. (16 Pick.) 107, 26 Am. Dec. 645 (1834); *Sanderson v. White* 35 Mass. (18 Pick.) 328, 29 Am. Dec. 591 (1836); *Parker v. May*, 59 Mass. (5 Cush) 336 (1850); *Jackson v. Phillips*, 96 Mass. (14 Allen) 539 (1867); *Attorney General v. Parker*, 126 Mass. 216 (1879); *Burbank v. Burbank*, 152 Mass. 254, 25 N.E. 427 (1890); *Attorney Genral v. Bedard*, 218 Mass. 378, 105 N.E. 993 (1914); *Dillaway v. Burton*, 256 Mass. 568, 153 N.E. 13 (1926); *Ames v. Attorney General*, 332 Mass. 246, 124 N.E. 2d 511 (1955).
MICHIGAN	*Attorney General v. Soule*, 28 Mich. 153 (1873).
MINNESOTA	*Longcor v. City of Red Wing*, 206 Minn. 627, 289 N.W. 570 (1940); *Schaeffer v. Newberry*, 227 Minn. 259, 35 N.W. 2d 287 (1948); *In re Estate of Quinlan*, 233 Minn. 35, 45 N.W. 2d 807 (1951).
MISSOURI	*Lackland v. Walker*, 151 Mo. 210, 52 S.W. 414 (1899); *State ex rel. Heddens v. Rusk*, 236 Mo. 201, 139 S.W. 199 (1911); *Dickey v. Volker*, 321 Mo. 235, 11 S.W. 2d 278 (1928); *Thatcher v. City of St. Louis*, 343 Mo. 597, 122 S.W. 2d 915 (1938).
MONTANA	*State ex rel. Ford v. Young*, 54 Mont. 401, 170 P. 947 (1918).
NEBRASKA	*In re Estate of Crighton*, 91 Neb. 654, 136 N.W. 1001 (1912); *State ex rel. Hunter v. Home Savings and Loan Association*, 137 Neb. 231, 288 N.W. 691 (1939); *In re Estate of Grbiny*, 147 Neb. 117, 22 N.W. 2d 488 (1946).
NEW HAMPSHIRE	*Rolfe and Rumford Asylum v. Lefebre*, 69 N.H. 238, 45 A. 1087 (1898); *Haynes v. Carr*, 70 N.H. 463, 49 A. 638 (1900). *In re Burnham*, 74 N.H. 492, 69 A. 270 (1908); *Souhegan National Bank v. Kenison*, 92 N.H. 117, 26 A. 2d 26 (1942).
NEW JERSEY	*Attorney General ex rel. Bailey v. Moore's Executors*, 19 N.J. Eq. 503 (1868); *Mackenzie v. Trustees of the Presbytery of Jersey City*, 67 N.J. Eq. 652, 61 A. 1027 (1905); *Larkin v. Wikoff*, 75 N.J. Eq. 462, 72 A.

	98 (1909); *Trustees of Princeton University* v. *Wilson*, 78 N.J. Eq. 1, 78 A. 393 (1910); *Bible Reader's Aid Society of Trenton* v. *Katzenback*, 97 N.J. Eq. 416, 128 A. 628 (1925); *Passaic National Bank & Trust Co.* v. *East Ridgelawn Cemetery*, 137 N.J. Eq. 603, 45 A. 2d 814 (1945); *Frank* v. *Clover Leaf Park Cemetery Association*, 29 N.J. 193, 148 A. 2d 448 (1959).
OREGON	*Wemme* v. *First Church of Christ, Scientist*, 110 Oreg. 179, 219 P. 618 (1923); motion to recall mandate denied 110 Oreg. 179, 223 P. 250 (1924).
PENNSYLVANIA	*Commonwealth ex rel. Minerd* v. *Margiotti*, 325 Pa. 17, 188 A. 524 (1936); *Weigand* v. *The Barnes Foundation*, 374 Pa. 149, 97 A. 2d 81 (1953); *In re Estate of Pruner*, 390 Pa. 529, 136 A. 2d 107 (1957); *In re Estate of Garrison*, 391 Pa. 234, 137 A. 2d 321 (1958); *Commonwealth* v. *The Barnes Foundation*, 398 Pa. 458, 159 A. 2d 500 (1960).
RHODE ISLAND	*Stearns* v. *Newport Hospital*, 27 R.I. 1309, 62 A. 132 (1905); *Newport Hospital* v. *Harvey*, 47 R.I. 382, 133 A. 648 (1926); *Powers* v. *Home for Aged Women*, 55 R.I. 187, 179 A. 610 (1935); *Leo* v. *Armington*, 74 R.I. 124, 59 A. 2d 371 (1948).
TEXAS	*Allred* v. *Beggs*, 125 Tex. 584, 84 S.W. 2d 223 (1935); *Powers* v. *First National Bank of Corsicana*, 138 Tex. 604, 161 S.W. 2d 273 (1942); *Boyd* v. *Frost National Bank*, 145 Tex. 206, 196 S.W. 2d 497 (1946).
VIRGINIA	*Clark* v. *Oliver*, 91 Va. 421, 22 S.W. 175 (1895).
WASHINGTON	*State* v. *Taylor*, 58 W. 2d 255, 362 P. 2d 249 (1961).
WEST VIRGINIA	*Goetz* v. *Old National Bank of Martinsberg*, 140 W. Va. 422, 845 S.E. 2d 759 (1954).

Footnotes

1. Bogert, "Proposed Legislation Regarding State Supervision of Charities," 52 *Mich. L. Rev.* 633 (1954); Forer, "Forgotten Funds: Suggesting Disclosure Laws for Charitable Funds," 105 *U. Pa. L. Rev.* 1044 (1957); Karst, "The Efficiency of The Charitable Dollar: An Unfulfilled State Responsibility," 73 *Harv. L. Rev.* 433 (1960).

2. Marion Fremont-Smith, *Foundations and Government.* (Russell Sage, 1965), pp. 250-68; Karst, ibid., 433, 476.

3. The power of the sovereign as parent of the country to protect the interests of those citizens who are incapable of protecting themselves (*i.e.* children, lunatics, dependents, charitable beneficiaries, etc.)

4. See generally, 4 Bogert, *Trusts and Trustees* §432 (2nd ed 1964); 4 *Scott on Trusts* §399.1 (3rd ed. 1967).

5. See, 3 *Story's Equity* §1548 (14th ed. 1918).

6. See, Fremont-Smith, op. cit., p. 24; 4 *Scott on Trusts* §391 (3rd ed. 1967).

7. See, "The Enforcement of Charitable Trusts in America: A History of Evolving Social Attitudes," 54 *Vir. L. Rev.* 436 (1968); 4 *Scott on Trusts* §348.2 (3rd ed. 1967); *Philadelphia Baptist Association* v. *Hart's Executors*, 17 U.S. (4 Wheat.) 1, 4 L.Ed. 499 (1819).

8. See, 4 *Scott on Trusts* §348.3 (3rd ed. 1967); *Vidal* v. *Girard's Executors*, 113 U.S. (2 How.) 127, 11 L.Ed. 205 (1844).

9. For additional cases and sources on the common law powers of the attorney general see, Cooley, "Predecessors of the Federal Attorney General: The Attorney General in England and the American Colonies," 2 *Am. J. Legal Hist.* 304 (1958).

10. See, for example, *Dilloway v. Burton*, 256 Mass. 568, 153 N.E. 13 (1926); But see *Brown v. Memorial National Home*, 329 P. 2d 118 (1958) for the proposition that a party in interest may be permitted to institute an action in the name of the attorney general, when the right to sue resides solely in that official.

11. See, *Ewell v. Snead*, 136 Tenn. 602, 191 S.W. 131 (1917).

12. See, 4 Bogert, *Trusts and Trustees*, §434 (2nd ed. 1964); *Minot v. Baker*, 147 Mass. 348, 352, 17 N.E. 839 (1888).

13. See, for example, *Passaic National Bank and Trust Co. v. East Ridgelawn Cemetery*, 137 N.E. Eq. 603, 45 A. 2d 814 (1945); *In re Estate of Pruner*, 390 Pa. 529, 136 A. 2d 107 (1957). For additional cases as to whether the attorney general is a necessary or merely a proper party see, 15 Am. Jur. 2d *Charities* §119 (1964); *Annot.* 62 A.L.R. 881 (1929); *Annot.* 124 A.L.R. 1237 (1940); 4 Bogert, *Trust and Trustees* §411 (2nd ed. 1964); 4 *Scott on Trusts* §391 (3rd ed. 1967).

14. See, *Commonwealth v. The Barnes Foundation*, 398 Pa. 458, 467, 159 A. 2d 500 (1960).

15. See, *Cannon v. Stephens*, 18 Del. Ch. 276, 159 A. 234 (1932).

16. See, 2 *Restatement (Second)*, Trusts §391 (1959).

17. See, for example, *Alexander v. New Jersey Power and Light Co.* 21 N.J. 373, 122 A. 2d 339 (1956); *Attorney General v. Williams* 174 Mass. 476, 55 N.E. 77 (1899).

18. Fremont-Smith, op. cit., p. 198.

19. See, *Kerner v. Thompson*, 365 Ill. 149, 6 N.E. 2d. 131 (1937); *Attorney General v. Bedard*, 218 Mass. 105 N.E. 993 (1914).

20. See, for example, *Healy v. Loomis Institute*, 182 Conn. 410, 128 A. 774 (1925); *State ex. rel. Hunter v. Home Savings and Loan Association*, 137 Neb. 231, 288 N.W. 691 (1939); *In re Los Angeles County Pioneer Society*, 40 Cal. 2d 852, 257 P. 2d 1 (1953).

21. See, *Commonwealth v. Barnes Foundation*, 398 Pa. 458, 159 A. 2d 500 (1960); *State v. Taylor*, 58 Wash. 2d 252, 362 P. 2d 247 (1961).

22. See, *State v. Taylor*, Supra note 21.

23. Fremont-Smith, op. cit., p. 253.

24. Ibid., p. 196.

25. This differs somewhat from the results of the Council on Foundations study which was done for the Commission. This difference is an interesting finding in itself. If it can be assumed that the council's statistics are correct, it says very little for the record-keeping ability of the states. On the other hand, the fair market value of some foundations' assets are difficult to appraise which would then indicate a divergent opinion on value only.

26. See, for example, Ginsburg, Marks, and Wertheim, "Federal Oversight of Philanthropy," draft report to the Commission on Private Philanthropy and Public Needs, 1974, pp. 182-183.

27. Testimony of Alan Pifer, president of Carnegie Corporation of New York, before the Subcommittee on Foundations of the Senate Committee on Finance, October 1 and 2, 1973.

28. Churches, their integrated auxiliaries, and conventions or associations of churches; any organization other than a private foundation as defined in section 509(a) described in

subparagraph (c), the gross receipts of which in each taxable year are normally not more than $5,000; or the exclusively religious activities of any religious order (IRC §6033(2)(A).

29. Treas. Reg. §1.6056 - 1(b)(3).

30. Treas. Reg. §301.6104-2(c).

31. Private in the sense that if the foundation is unwilling to provide a copy of their annual report, the state or individual must follow cumbersome detailed procedures set out in the IRC regulations (§6104). One wonders if the rules applicable to public inspection of public foundation reports were designed to obstruct rather than promote public knowledge.

32. Although section 4240 falls within chapter 42, a deficiency of tax under this section would not result as a consequence of any violations but generally as a result of an incorrect computation of excise tax.

33. Section 508(*e*) of the Internal Revenue Code provides that a private foundation shall not be exempt from taxation unless its governing instrument contains the chapter 42 prohibitions and requirements. It also provides that a private foundation's governing instrument is deemed to conform with these requirements if valid provisions of state law have been enacted which require it to act or refrain from acting in such a manner so as to subject it to the chapter 42 taxes. Table 2 lists the states that have passed such legislation. Therefore, should a private foundation be taxed under chapter 42, the states still may take further action to correct those abuses.

34. A copy of an organization's exemption application may be requested at any time, notwithstanding these requirements. However, if the organization has been in existence for a number of years, it may be outdated and of little value.

35. See, for example, Ohio Rev. Code §2109.02, *et seq.*; Restatement (Second) of Trusts, §171 at 374.

36. II Scott, *The Law of Trusts*, §170 (3rd Ed. 1967).

37. Ibid.

38. Ibid.

39. Restatement (Second) of Trusts, §180 at 1451 (1959). For a more indepth discussion of these duties, see A. Scott, *The Law of Trusts*, §163A-185.

40. *Stern et al. v. Lucy Webb, Haynes National Training for Deaconesses and Missionaries et al.* (D.C. July 1974).

41. 3 Scott *Trusts* §391 (1st ed. 1939).

42. See generally, Bogert, "Proposed Legislation Regarding State Supervision of Charities," 52 Mich. L. Rev. 633, 641 (1954).

43. Handbook of the National Conference of Commissioners on Uniform State Laws (1954), p. 169.

44. Forer, op. cit., pp. 1044, 1050.

45. Karst, op. cit., pp. 433, 457.

46. Ibid., pp. 433, 476.

47. Fremont-Smith, op. cit., p. 265.

48. Karst, op. cit., pp. 443, 456.

49. Klapp and Wertz, "Supervision of Charitable Trusts in Ohio: The Ohio Charitable Trust Act," 18 *O.S.L.J.* 181.

50. Fremont-Smith, op. cit., pp. 250-268.

51. Forer, op. cit., pp. 1044, 1055.

52. Ibid., pp. 1044, 1057.

53. Handbook of the National Conference of Commissioners on Uniform State Laws (1972), p. 192.

54. Rogerson, "The Uniform Management of Institutional Funds Act," 8 *Real Prop. Prob. and Tr. J.* 405 (1973).

55. Ibid.

56. Ibid., p. 407.

57. Ibid.

58. Ibid., p. 409.

59. Ibid.

60. *Kerner* v. *Thompson*, 365 Ill. 149, 6. N.E. 2d 131 (1937); *Attorney General* v. *Bedard*, 218 Mass. 378, 105 N.E. 993 (1914).

61. An example of this is found in the Los Angeles Municipal Code §44.01-.19 (1955). Section 44.12 requires all solicitors for charity to carry an information card, and to read it to any person solicited, or to present it to the person for his perusal. The information card is to give information on "What portion of the contributions collected as a result of the solicitation will remain available for application to the specific purposes declared . . . as the object of the solicitation." Los Angeles Municipal Code §44.05(e) (1955).

62. The members of the Ad Hoc Committee were John J. O'Connor, legal counsel to The National Foundation; Mrs. Helen O'Rourke, Solicitations Review Section, Trade Practices Department, Council of Better Business Bureaus, Inc.,; Arthur J. Grimes, Director for Membership, National Health Council, Inc.; John J. Schwartz, president, American Association of Fund-Raising Counsel, Inc.; Henry C. Suhrke, editor, *Non-Profit Report* (presently the *Philanthropic Monthly);* and Ms. Joan McC. Lundberg, director of public relations, American Association of Fund-Raising Counsel, Inc.

63. For example see, Ohio Revised Code Chapter 1716.

64. Ibid.

65. See, for example, Ann. Laws of Mass. Ch. 68. §22 (1964); Pa. Stat. Ann. tit. 10, §160-6 (1963); Wash. Rev. Code Ann. §19.09.100 (1974).

66. *United States* v. *Stores Broadcasting Co.*, 351 U.S. 192, 76 S. Ct. 763, 100 L.Ed. 1081 (1956).

67. Davis, 1 *Administrative Law Treatise* §7.07.

68. *Hagar* v. *Reclamation District*, 111 U.S. 701, 4 S. Ct. 663, 28 L.Ed. 569 (1884); Davis 1 *Administrative Law Treatise* §7.10.

69. *Panama Refining Co.* v. *Ryan*, 293 U.S. 388, 55 S. Ct. 241, 79 L.Ed. 446 (1935); *Carter* v. *Carter Coal Co.*, 298 U.S. 238, 56 S. Ct. 855, 80 L.Ed. 1160 (1936).

70. Davis, 1 *Administrative Law Treatise*, §2.07.

71. *Reetz* v. *Michigan*, 188 U.S. 505, 23 S. Ct. 390, 47 L.Ed. 563 (1903). See also Jaffee, "*The Right to Judicial Review II*," 71 *Harv. L.R.* 769 (1958).

72. *Helvering v. Mitchell*, 303 U.S. 391, 58 S. Ct. 630, 82 L.Ed. 917 (1938).

73. Davis, *Administrative Law Treatise*, §2.13, 28.14, 24.18-19.

74. *Home Building & Loan Association v. Blaisdell*, 290 U.S. 398, 54 S. Ct. 231, 78 L.Ed. 413 (1934).

75. *El Paso v. Simmons*, 379 U.S. 497, 85 S. Ct. 577, 13 L.Ed. 2d 446 (1965); *Cantwell v. Connecticut*, 310 U.S. 296, 60 S. Ct. 900 84 L.Ed 1213 (1940).

76. *Home Building & Loan v. Blaisdell*, supra note 74, at 404.

77. *Cantwell v. Connecticut*, supra note 75.

78. Ibid.

79. Ibid.

80. *Gospel Army v. Los Angeles*, 27 Cal. 232 at 245, *appeal dismissed* 331 U.S. 543 (1947).

81. Language to this effect has been upheld by the 5th Cir. in *Nat'l Foundation v. City of Fort Worth*, 415 F.2d 41 (5th Cir. 1969), *cert. denied* 396 U.S. 1040 (1969).

SELF-REGULATION IN PRIVATE PHILANTHROPY

Peter G. Meek†

Introduction

This report is concerned with activities initiated and carried out by the private sector to affect the use of funds either bequeathed or contributed by the public for philanthropic purposes. (By and large, these gifts are tax-exempt to the donor because they are given to and spent by organizations that are exempt from taxation because of the purposes for which they exist.) Broadly defined as self-regulation, the activities presented here complement and supplement regulation by federal, state, and local governmental units.[1]

Almost all of the significant self-regulatory activities conducted in the private philanthropic field in the United States as of the summer of 1974 are discussed in the following pages. Limitations of time and funds did not permit a more comprehensive study; self-regulatory activities within specific religious fields and within single organizations at the national, state, and local levels receive only passing reference, for example. The general coverage is intended to provide the Filer Commission with an understanding of the purposes and scope of self-regulation in philanthropy today.

I

SELF-REGULATION IN PHILANTHROPY: OVERVIEW AND SELECTED EXAMPLES OF PRIVATE EFFORTS WITH REGULATORY POTENTIAL

Regulation is most commonly defined as accomplishing conformity to law. Regulatory bodies are usually governmental entities or have powers delegated to them by legislative bodies. There is a potential coercive presence stemming from law or a court order. Therefore, to use the term "regulation" to describe efforts undertaken voluntarily by groups having no responsibility derived from law may be technically inaccurate and semantically inappropriate. However, there was little misunderstanding during this study of what was meant when "self-regulation" was discussed in the context of organizations concerned with philanthropy.

Considering the dimensions of philanthropy in the United States, regulation of philanthropy – both from within the field and from federal, state, and local government – has been slow in coming and limited in its scope and application. In 1974 alone, $25 billion was contributed for philanthropic purposes; countless millions of Americans volunteered their time and effort as well as contributing their money.

Contributed funds and volunteer time and effort are the life-blood of voluntary organizations. In the case of organizations that do not have a built-in constituency, such as the members of a fraternal order or a hospital auxiliary, it is absolutely essential that public interest and concern be maintained at a high level so that the needed funds and time will be contributed. Public approval of the cause and public confidence in the use being made of contributions are fundamental to the survival of private philanthropic organizations.

In the early days of our history this approval and confidence were readily gained. As everything in the United States grew bigger and more numerous – including charitable causes and the amount of funds involved – the need to maintain public confidence and encourage public support became a matter of increasing concern to the philanthropic community. In 1882 the Contributors Information Bureau was established by the Charity Organization Society of New York City to provide contributors with information about a soliciting organization so that they could make an informed decision about whether to contribute money and time. If this decision was affected by the information provided by the bureau, a regulatory role was being performed since this private organization had formulated standards for judging the solicitation appeal of a given charitable organization; it was hoped that contributors would support those soliciting organizations that met the bureau's standards and would be discouraged from supporting a sub-standard charity. The adversely affected charity, in order to survive, would strive to meet the bureau's standards. This is a rationale for self-regulatory activities in the philanthropic field.

---

† Former executive director, National Health Council; Ridgewood, New Jersey.

Guidance for the contributor, with its corollary of assurance that the contribution will be properly spent, was a concern of the private sector long before the federal government, in the late 1940s, and the states, beginning in 1950, began to enact legislation to correct tax abuses in the name of charity and to require state registration and supervision of charitable organizations.

Standard-Setting and Accreditation

The private sector's concern has not only been to keep the contributor's attitudes properly positive and the contributions flowing in ever-increasing amounts. The vast majority of philanthropic organizations also realize that they must earn whatever public confidence and approval they need and must perform their role as effectively as the contributors assume they do.

Much of early philanthropy was devoted to education, social welfare, civic betterment, and health. In these fields there was a tradition of professional performance standards formulated and administered by peers. Teachers, physicians, dentists, nurses, and social welfare workers attended schools that were accredited by bodies set up for this purpose by their respective professions. Accreditation has become the widely used and accepted measure of quality.

Thus it was understandable that the concept of setting standards should be introduced into the judging of charitable organizations. Just as the public was encouraged to use the services of professionals who had been trained in accredited institutions and certified by a body of their peers, so, too, was it logical that contributors be encouraged to give their time and money to organizations that met specified and recognized standards.

The development of quality controls in industry, the current emphasis on standards for acceptable air and drinking water and for safer automobiles, even "the standard of living" – all are well-known examples of concern for rational measurement and evaluation of the quantity and quality of what the nation does and produces. Standard-setting has developed out of a specific, strongly felt need for nationally recognized guidelines for quality service. Not surprisingly, the basic approach in each new area has been similar. Typically, standards reflect contemporary research and professional judgment ("best practice") and are concerned with requisite characteristics (inputs), service delivery (process), and results obtained (outputs). Once developed, standards are publicized, disseminated, and utilized by agencies to improve their administration and services. Ultimately, they are used in accreditation.

Ewald B. Nyquist, then deputy commissioner and now commissioner of New York State Department of Education, described accreditation as follows:

> Accrediting is an American phenomenon; it is not in existence in any other country. This is because this country was founded on a system of dispersed

> controls, voluntary association, a separation of powers, in short, a 'reluctance to rule.'
>
> Thus, the rationale for accreditation in the United States is contained in the same concepts which established democracy in America: Those freedoms conducive to and in support of self-government and voluntary cooperation rather than outside restraints which lead to imposed directives and planning by centralized authority . . .[2]

Thus the objective of standard-setting is not only to reassure contributors, patients, and customers. Self-discipline through voluntary regulation is also viewed as more desirable than regulation by governmental agencies wielding the force of law.

However, as the scope of charitable activities grew bigger, and as more funds were involved and the problems became more complex, an underpinning of law became an essential complement to the developing voluntary efforts to regulate through standardizing and accreditation. Standard-setting in private philanthropy is today largely carried on in shared responsibility with law enforcement agencies. Licensing of practitioners and institutions is a common public function to assure that these persons and institutions are at least qualified by some standard that will guard the public safety. All tax-exempt organizations must report annually to the federal government. Private foundations must meet certain new requirements under the Tax Reform Act of 1969. In many states, public charities must register with state or local governments. (Other reports prepared for the Commission on Private Philanthropy and Public Needs will describe the scope and effectiveness of these legally based regulatory activities.)

Despite the existence of these legally based regulatory activities, self-regulation to assure public confidence and support and to improve the quality of organizational performance and service continues to be an important principle in private philanthropy. It is consistent with the American way of free enterprise, of which private philanthropy is an important expression. The legal underpinnings are there to strengthen and encourage – not supplant – self-regulation. But self-regulation must have impact if it is to accomplish the purposes for which self-regulatory mechanisms have been created.

In higher education and health institutional services, accreditation mechanisms have been effective self-regulatory devices partially because the public has been educated to appreciate accredited universities, schools, hospitals, and nursing homes. Another important factor in the effectiveness of these mechanisms is that practitioners value their association with accredited institutions. Then, too, it has been implicit in court decisions involving accreditation matters that as long as the decisions of accrediting bodies are based on expert knowledge and judgment they would not be questioned or examined in substance by the court. Operational questions regarding the procedures of the accrediting bodies have, however, been considered to be within the purview of the court.

Accreditation and the Role of the Federal Government

An additional and most powerful force contributing to the self-regulatory effectiveness of higher educational and health service accrediting bodies has been the role of the federal government. The Congress, in legislation, has provided that federal support for higher education shall go only to accredited schools. Veterans, for example, are protected from sub-standard education by requirements that federal funds shall go only for courses in schools accredited by national accrediting bodies recognized by the U.S. Commissioner of Education. Hospital care for Medicare patients and hospital construction and other activities supported in part by federal funds must, by law or regulation, meet the standards of recognized accrediting bodies in order to qualify for federal support.

The principal purposes of these federal laws and regulations have been to safeguard from mismanagement or misuse the investment of public funds and to secure the best possible assurance that the funds expended can be expected to produce results of the best quality. At the same time federal, state, and local governments are spared costly development and administration of detailed criteria of their own.

The existence of respected voluntary accreditation systems, evolving to meet changing needs in higher education and health institutional services, has been a continuing example of citizens' ability to solve complex problems for themselves. Recognizing this, the federal government has sought to avoid unnecessary expansion and inappropriate encroachment into these areas. It has utilized existing voluntary accrediting systems to safeguard federal funds and program goals.

Standard-Setting to Guide and Encourage Public Support

For those major areas of private philanthropy that rely more heavily on broad support from the general public – religious, fraternal, patriotic, civic, cultural, general health and welfare – self-regulatory activities are found in a wide variety of organizations, national, state, and local. In general, these activities are of two types. Some are primarily intended for protection of the contributor and are operated under auspices independent of the soliciting organizations. (These activities are not strictly "self" regulatory, but they are so considered in this report since they are regulatory efforts in the private sector and are carried on independent of any legislative mandate.) Others have been established by the organizations that are to be regulated and are operated to implement standards for effective performance developed within the field, standards that will, in turn, result in protection of the contributor.

Most of this report is a description of some of the most significant of both types of self-regulatory activities. Two of the organizations described in subsequent chapters, the National Information Bureau and the Philanthropic Advisory Department of the Council of Better Business Bureaus, are operations of the private sector but not of the philanthropies themselves. The other organizations described have been established by philanthropic organizations or with philanthropic funds.

Standard-Setting Within Single Organizations

In addition to their participation in the standard-setting programs of organizations described in this report,[3] many voluntary organizations maintain internal programs to assure the quality of the performance of their own affiliates. Chapter V discusses the standard-setting programs of United Way of America for organizations it supports through United Way fund raising. The national United Way also administers a program for its own affiliates, identified as *Standards of Excellence for Local United Way Organizations.* Organizations such as the Child Welfare League of America, the Family Service Association of America, the American Heart Association, the National Easter Seal Society for Crippled Children and Adults, the National League for Nursing, and the National Council for Homemaker/Home Health Aide Services operate programs for their state and local affiliates through which attainment and maintenance of standards is sought. An examination of the regulatory effectiveness of these internal programs is beyond the scope of this report. But it is important to recognize that many such programs do exist and probably contribute substantially to assurance of quality performance in philanthropy.

Also beyond the scope of this report is an assessment of the impact on standard-setting that may have resulted from thousands of community studies that have been made of human service needs and programs and the effect on support of philanthropic activities that these studies may have had.

The Advertising Council

The Advertising Council is a national voluntary organization created in 1945 by the advertising industry to "help improve the welfare of the American people as a whole, and in so doing demonstrate to the public that the advertising community is concerned with the public welfare and to show that advertising is a powerful force for public service." Financed by the industry and by many other U.S. business firms, the council's principal activity is the development and promotion of major public service campaigns through the communications media on subjects of general public interest. Citizens, being better informed as a result of these campaigns, will be stimulated to take actions that will benefit them and their neighbors or be deterred from pursuing socially damaging activities. In 1970, support for the council's major campaigns from local and national advertising communications media was, in terms of commercial rates, estimated to be worth more than $450 million. "Council campaigns have helped raise billions of dollars for such diverse causes as the American Red Cross, United Community Funds and Councils, Religious Overseas Aid, Care and USO," states a council brochure. (The council has operated a campaign for the Council for Financial Aid to Education since 1957, during which time contributions to private colleges and universities have increased from $738 million to $1.8 billion annually.)

The council issues a Public Service Advertising Bulletin every two months as a "guide to media, advertisers and advertising agencies." In addition to information about the 20 or so major campaigns that the council may be conducting, this bulletin recommends to the media for advertising support those philanthropic organizations that meet the council's standards. The standards applied by national radio and television networks to nonprofit advertising are not as rigorous as those applied to commercial accounts. The council's bulletin encourages recognition of organizations that meet standards.

In deciding which organizations to recommend, the council staff applies the following criteria formulated by the council's board:

1. That, if the organization is a fund-raising one, the Advertising Council will take into consideration whether or not it currently meets the standards of the National Information Bureau. (See Chapter III for a description of the National Information Bureau.)

2. That the project be non-commercial, non-partisan, and not designed to influence legislation.

3. That the project be national in scope, or sufficiently national so that the great bulk of the national media audience has an actual or potential interest in it.

4. That the appeal for support shall be one properly made to Americans generally. The project will not be rejected because it is in the interest of one group if it has wide appeal.

5. That the project be of sufficient seriousness and public importance to justify treatment before the national media audience.

From about 300 requests per year, some 60 to 75 organizations are selected by the council's Public Policy Committee for inclusion in the bulletin. Frequently, organizations are rejected because they are not sufficiently national in scope. The potential for obtaining precious media coverage through inclusion in the council's recommended group is so great that all national philanthropic organizations dependent on public support make every effort to meet the council's standards. Because of limited staff assigned to this activity of the council, it is necessary to rely heavily on available information from other sources in reaching decisions. Thus, the reports of the National Information Bureau, readily available and usually including a judgment about the organization, have been influential in the administration of the council's program.

The National Council on Philanthropy

The National Council on Philanthropy (NCOP), an organization composed of representatives of both charitable donors and donees, sponsors an annual national forum at which the support of philanthropy is the central topic. These NCOP meetings are the present-day version of the National Conference on Solicitations which was formed in 1954 in Cleveland as an outgrowth of a meeting sponsored by the Cleveland Chamber of Commerce and the National Information Bureau. The conference was created "for the cooperative study of contribution problems, policies and procedures." The conference and its successor organization, the National Council on Philanthropy, expressly state that their function is not that of investigating or screening charitable solicitations. The programs at these annual gatherings are concerned primarily with providing givers and beneficiary organizations an opportunity to discuss common problems. For example, the 1974 meeting sought new directions in meeting philanthropic tasks and "better results by better management." While formal standard-setting is not an objective, the entire thrust of this privately supported organization is to strengthen private philanthropy.

Contributor Protection at the Community Level

At the community level, regulatory efforts by the private sector principally on behalf of the giver are carried on by Better Business Bureaus and Chambers of Commerce. The developing program of the Philanthropic Advisory Department of the Council of Better Business Bureaus described later in this report (Chapter IV) is expected to influence the extent and quality of these local regulatory efforts as new national standards are distributed and applied. Presently, this function of these business-oriented organizations is primarily conducted as a service to their membership, rather than to the general public. Adverse judgments about certain campaigns by some of these private, self-constituted evaluating bodies have been challenged in the courts. Liability to suit has inhibited the growth of regulatory devices such as this, especially as a general community service. In the 1950s the organizers of the National Conference on Solicitations tried to encourage replication of the program of the Cleveland Chamber of Commerce in other communities, but with limited success. The Financial Support Review Committee of the Greater Cleveland Growth Association (Cleveland Chamber of Commerce) is one of the oldest and best organized of the local regulatory programs and among such organizations is unique in the extent of its regulatory effort.

Established at the turn of the century as a Committee on Benevolences, the Financial Support Review Committee is to provide timely and factual information to help members make informed decisions on contributions. The committee consists of about 40 members, representing a broad segment of business and industry in Greater Cleveland, who are directly involved with their company's contributions program. Each member is assigned to one of three subcommittees – education and culture, health and welfare (including medical services), civic and urban affairs – responsible for reviewing and evaluating all national, state, or local campaigns that, under local leadership, seek funds on an organized basis in the community.

When a campaign comes to the committee's attention, the organization heading the campaign is asked to furnish information about its purpose, program, fund-raising practices, budget, governing board, and so forth. The subcommittees often ask officials of campaigning organizations to furnish further information in person; they also consult with experts in their fields of interest and use any reports on the campaigning organization available from the National Information Bureau.

The subcommittees determine if the campaign meets the criteria required for approval. These criteria are an elaboration on and extension of the standards used by the National Information Bureau. Campaigns conforming to the standards are then considered in the light of their relative importance to community needs and are voted one of three priority ratings. The committee handles about 500 appeals per year; it rules unfavorably on more than 50 percent of these. Many of the rejections are direct mail appeals from organizations outside the community.

The committee's decisions are summarized in the monthly newsletter of the Growth Association. According to the committee's staff, the members of the association are substantially influenced by the committee's recommendations. It is reasonable to assume, therefore, that those philanthropic organizations that could qualify for the association's approval will strive to meet its standards. It is also probable that the influence of the committee's decisions goes beyond its membership since local media representatives serve on the committee, are members of the association, and receive the monthly bulletin.

Self-Regulation of Fund Raisers

A crucial element in all but the very well-endowed private philanthropies is the fund raiser. Many fund raisers are employed directly by philanthropic organizations; others work as free-lancers or are partners or employees of fund-raising firms.

Self-regulation in the fund-raising field is in its infancy. Fund raisers are not licensed in any state, and there are no estimates as to the total number of persons who may be engaged in this activity as a livelihood. In 26 states, fund raisers who work independently must register, and most are required to be bonded. Several private organizations of fund raisers are currently engaged in some form of regulatory activity. While the ultimate regulatory target must, of course, be the agency or institution that will use the philanthropic contribution, adherence to acceptable fund-raising practices by those raising the funds can be an important component in generating public confidence in the recipient agencies and institutions.

National Society of Fund Raisers, Inc.

The National Society of Fund Raisers was incorporated in 1960 and has a national membership of approximately 1,000. There are chapters in a number of the major cities. In its by-laws, the society's purpose is stated in part as follows: "assisting its members in their professional efforts by fostering ethical standards for the management, direction and counseling of fund-raising programs for philanthropic institutions and agencies."

The society has adopted a Code of Professional Practice to which all members must conform. Supervision of adherence to the code is vested in an Ethics Committee, composed of members of the society. In addition to having three consecutive years of experience as a fund raiser, applicants for membership must be in a "professional position . . . (that) . . . accords with the Code of Professional Practices of the National Society."

In 1971 the society established an Institute of Continuing Education; by 1974 this separately incorporated, tax-exempt activity was financed and ready to begin conducting seminars for the members. Leaders of the society view this institute as the first major step on the road to greater professional identity and to a possible program of accreditation.

Since the field of fund raising is so amorphous and the numbers of individuals involved is unknown, it is difficult to assess the regulatory impact of a standard-setting organization such as the society. The very fact that large numbers of persons who are engaged in fund raising either cannot qualify for membership in the society or feel no need to do so indicates the limited effect of the organization's standard-setting efforts. The number of persons who seek membership and are rejected was not available through the national headquarters since the initial action on applications is taken by the local chapters and refusals are not reported nationally. It seems safe to assume, however, that membership in the society has not yet become widely recognized as a measure of competence essential for employment in fund raising.

National Association for Hospital Development

The National Association for Hopsital Development is the professional organization for approximately 600 of the persons employed in a fund-raising capacity by the nation's 3,000 voluntary, nonprofit hospitals, medical centers, and similar large health care institutions. These individuals are generally not members of the National Society of Fund Raisers since the two organizations serve essentially the same purpose for their respective members.

The National Association for Hospital Development launched an accreditation program for its members in October 1974. This is not compulsory for members, but they are encouraged to take the examinations for one of the three levels of accreditation. A Code of Ethics has also been developed. The potential for effective self-regulation is greater here than with the National Society of Fund Raisers since the field in which the association's members are active is more well defined and hence more manageable.

Voluntary hospitals are increasingly employing individuals to engage in financial development work. The exact number of such employees is not known. It is difficult for hospitals to identify suitably qualified personnel for this activity, and an accreditation system may be welcomed and encouraged by the hospital field for hospital fund raising, which in in 1973 amounted to about $2 billion from private philanthropy.

American Association of Fund-Raising Counsel, Inc.

The American Association of Fund-Raising Counsel is the membership association of fund-raising firms. Twenty-seven leading firms belong to the association, finance it, and operate it in the interests of creating a favorable climate for philanthropy in this country, and, obviously, also a favorable climate in which they can operate. Members of the association are required to adhere to a Fair Practice Code:

> Member firms will serve only those philanthropic institutions or agencies whose purpose and methods they can approve. They will not knowingly be used by any organization to induce philanthropically inclined persons to give their money to unworthy causes.
>
> Member firms do business only on the basis of a specified fee, determined prior to the beginning of the campaign. They will not serve clients on the unprofessional basis of a percentage or commission of the sums raised. They maintain this ethical standard also by not profiting, directly or indirectly, from disbursements for the accounts of clients.
>
> The executive head of a member organization must demonstrate at least a six-year record of continuous experience as a professional in the fund-raising field. This helps to protect the public from those who enter the profession without sufficient competence, experience, or devotion to ideals of public service.
>
> The Association looks with disfavor upon firms which use methods harmful to the public, such as making exaggerated claims of past achievements, guaranteeing results, and promising to raise unobtainable sums.

No payment in cash or kind shall be made by a member to an officer, director, trustee, or advisor of a philanthropic agency or institution as compensation for using his influence for the engaging of a member for fund-raising counsel.

In fairness to all clients, member firms should charge equitable fees for all services with the exception that initial meetings with prospective clients are not usually construed as services.

It is difficult to judge the regulatory effect of the association's code since it is not known to what extent membership in the association and adherence to its code has been a decisive factor in enabling fund-raising firms to function successfully and remuneratively. It is known, however, that only 12 to 15 fund-raising firms in the country are not members of the association, and these are not large operations. The Code of Fair Practice, therefore, is probably an influential standard-setting activity for fund-raising firms.

II

THE AD HOC COMMITTEE (1959-1961)

Background

"In 1958 a group of private citizens, recognizing the important role of voluntary health and welfare agencies in the United States, undertook to reassess the functioning of these agencies in fulfilling their great responsibility. The Committee came together at the invitation of the Rockefeller Foundation." So begins the foreword of the 1961 report of the Ad Hoc Committee.[4]

Rockefeller Foundation officials had been engaged in a series of discussions with national organizations that had sought the interest and support of the foundation for a study of what was regarded as the chaotic and increasingly unacceptable proliferation of public fund-raising campaigns, especially campaigns of national health groups appealing for funds for support of specific diseases and for other causes. These campaigns were regarded by many community planning bodies as too narrow to warrant the risk of abuse of public patience and tolerance that would ultimately result from too many different requests for public support.

During the 1940s and 1950s, the proponents of the consolidation of these public fund-raising efforts into combined and less numerous campaigns and the proponents of the right of the public to decide whether to respond to an individual cause had become involved in increasingly acrimonious debate. In some communities the combined or federated point of view was sufficiently influential so that local ordinances were enacted in efforts to control the solicitation of citizens in their homes for support of causes. Some of the major national voluntary health agencies, notably the then-National Foundation for Infantile Paralysis (now the March of Dimes) and the American Heart Association, successfully challenged such local ordinances. Decisions against local restrictions in Alhambra, California, and Park Ridge, Illinois, reinforced the position of the so-called "independents" that citizens had the right to make their own decisions as to what causes they would support.

Leaders of United Community Funds and Councils, Inc., the national membership organization for most community health and welfare planning councils and most community chests, sought to interest the Rockefeller Foundation in a study which, they doubtless hoped, would lead to strong support for control of the damage that they considered was being done to the concepts of orderly planning and judicious allocation of the public's charitable contributions.

It was probably unrealistic to hope that any one group could consolidate the public appeals of all charities, especially since charitable activities of religious bodies have in our society commonly been regarded as sharing the sacrosanct status of "freedom of religion" contributions, and no secular group could hope to intervene in the fund raising for churches or church-related activities. Nevertheless, the leadership of United Community Funds and Councils believed that important inroads might be made into what it considered to be an unfortunately chaotic situation and that this would ultimately benefit all voluntary health and welfare activities.

In 1941, 17 years before the Ad Hoc Committee was established, the Rockefeller Foundation had made funds available for a three-year study of voluntary health agencies under the auspices of the National Health Council. The study report, generally known as the Gunn-Platt Report, was issued in 1945, one year after the study was completed.[5] The report recommended, among other measures, "the pooling of the present separate competitive and confusing appeals of the voluntary national health agencies into a unified nationwide campaign (together, perhaps, with the welfare agencies), effective at the local, state and national levels . . ." Having concluded that this recommendation was even farther from realization in 1959, the UCFCA group hoped that the Rockefeller Foundation was ready to take another look at the "competitive appeals" situation in the voluntary field.

The foundation, however, decided to take a broader look at the operations of voluntary agencies in this country.[6] Lindsley Kimball, who at the time was vice-president of the Rockefeller Foundation, was quoted in the *New York Herald Tribune* as stating that the Ad Hoc Committee "was established in the first instance in response to very widespread, very urgent, and very earnest and sincere pleas from troubled citizens from coast to coast . . . Twenty-one citizens were asked to serve on the committee and twenty-one accepted and only because of their anxiety to strengthen the American way of voluntary giving." The foundation appointed the 22-member Ad Hoc Committee to "reassess the functioning of these agencies [all voluntary health and welfare agencies] in fulfilling their great responsibilities." Mr. Kimball, who later was associated with The Rockefeller Institute and the Rockefeller Brothers Fund, served as committee chairman.

The Rockefeller Foundation provided the financial support for the study, but the "sole responsibility" for the content of the report and its recommendations was attributed to the committee. Despite this published disclaimer, the report has been commonly identified with the Rockefeller Foundation or with Dr. Robert H. Hamlin, the study director and, at that time, associate professor of public health administration at Harvard University School of Public Health.

During 1960 and 1961, Dr. Hamlin "conducted more than 500 interviews with voluntary agencies, government organizations and interested groups and individuals." The committee's findings and recommendations were based on these interviews, in addition to other information compiled by the study staff, reports of consultants and advisory groups, and "the knowledge acquired by the Committee members in their many years of service to voluntary agencies."

One of the incidental contributions of the study was its compilation of national statistics on voluntary agencies which has not, to this author's knowledge, been supplanted or refined by any subsequent study. The study report states: "Added to the more than 100,000 voluntary health and welfare agencies that now solicit contributions from the general public are another 100,000 fraternal, civic, veterans and related organizations that sponsor some health and welfare activities. Many of the 300,000 churches in this country also offer various types of health and welfare services." While undoubtedly out-of-date now, these statistics, derived mainly from Internal Revenue Service information, were in general use for many years.

The report sounded a familiar theme: "to have democracy, we need to be sure that the price we pay is a necessary concomitant and that the product is worth the price. Moreover . . . it is well to remember that the warm climate of good will and the fertile soil of available dollars may produce an increasing conflict of vested interests — a conflict which, if continuing uncontrolled, could destroy much of the good will and threaten much of the support – thus unhappily leading toward government monopoly in the health and welfare fields...."

Of special relevance to the concerns of the Commission on Private Philanthropy and Public Needs is this observation made by the report: ".....of greater importance is the increasing number of individuals who question the wisdom of continuing a government tax policy that stimulates further growth of voluntary agencies. Since contributions to non-profit charitable organizations are now tax deductible and agency income and property are tax exempt, funds which would otherwise go in part to the government as taxes become an important source of income for voluntary agencies. While the great majority of the public does not now advocate a change in this tax policy, the questions raised indicate an increasing lack of confidence in voluntary agencies."

The Ad Hoc Committee's report pointed to the great contributions of voluntary health and welfare agencies, the inefficiencies of the organizations functioning in the field, the unavailability of reliable nad useful data about the quantity and quality of programs and services, and the absence of effective leadership for coordination, evaluation, and public accountability.

The committee concluded that "no final answers" to the problems identified "were possible or perhaps desirable. Progress might consist rather in placing better guidelines along the way. The Committee...would try...to chart a reasonable path – leaving ultimate answers to history." Accordingly, the committee presented two principal recommendations:

> The appointment and financing of a National Commission on Voluntary Health and Welfare Agencies "to continue the Committee's unfinished tasks"; and
>
> the development of uniform accounting and financial reporting for voluntary agencies.

The publication of the report was announced July 31, 1961; 47,000 copies were distributed in the first six months. The report's recommendations were the subject of comment and endorsement in more than 300 newspapers and magazines. Dr. Hamlin made many speeches in support of the report's recommendations and wrote a number of articles expanding on and interpreting the report's objectives.

In light of the developments that followed publication of the committee's recommendations, it is interesting to note the following editorial comment in the *Herald Tribune* on August 1, 1961:

> The Hamlin report recommends a national commission to be appointed by one or more of the big foundations, which would go on evaluating, planning and no doubt writing more criticism. This could be useful, although not much is to be expected out of the average commission.
>
> Another major proposal, however, sounds much better, which is to develop a system of uniform accounting and financial reporting. That way the public could compare agency performance and decide better where to give and how much.
>
> It is obviously wrong that there should be any wasteful competition among the agencies. The desire must be to serve efficiently and economically. If this isn't done so plainly that no reasonable cause for complaint exists, the case for increased government take-over will grow. And let no taxpayer think that this would be any better or cheaper.

Editorial comment in *The New York Times* was less skeptical about the prospects for the proposed national commission and endorsed both major recommendations. Again, the spectre of "government regulation" was cited as a reason why these steps should be taken by the private sector.

A news release from AFL-CIO on August 8, 1961, noted that "organized labor would give its wholehearted support to the establishment of a National Commission on Voluntary Health and Welfare Agencies...." The spokesman was the late Joseph A. Beirne, who had been a member of the Ad Hoc Committee.

Others were less enthusiastic: Some of the major national health agency leaders objected to the report's generally critical tone and rejected the proposal that a "national commission" was needed or appropriate. In their opinion, the committee was, in effect, questioning the integrity of dedicated and honorable volunteers and the effectiveness of existing laws by proposing the creation of what they considered to be a super-body.

Action on Recommendation for a National Commission on Voluntary Health and Welfare Agencies

According to the Ad Hoc Committee's report, the purpose of recommending a national commission was to continue and expand the functions of the committee. The national commission would consist of no more than 20 "leading citizens who reflect the public interest rather than partisan viewpoints." It would be "impartial and independent of the voluntary agencies. It should therefore be appointed preferably by a foundation or a group of foundations. Direct endorsement...by the President of the United States would be desirable..."

Basic financing was to be provided by the same foundation or group of foundations that appointed the commission members. The initial life of the commission was to be five years.

The primary purpose was to undertake a thorough evaluation of the role of voluntary agencies in modern society: "The National Commission would present to the American public a series of reports and recommendations on current and newly evolving problems of voluntary agencies. It could see that uniform accounting and financial reporting is developed.... It could initiate studies of criteria for the evaluation of voluntary agencies, public attitudes toward the agencies, coordinated planning for health and welfare services, and voluntary agency support of research and professional education. On occasion, the Commission could cooperate with voluntary agencies and community groups which request assistance in solving their own problems."

The commission would prepare a series of reports covering the following areas:

Evaluation of those existing national associations that might serve as coordinating forces in the voluntary agency field.

Reviews of cooperative planning among groups of national voluntary agencies.

Compilations and comparisons of expenditures by voluntary agencies, both federated and independent.

Analysis of the impact of different fund-raising methods on programs.

Analysis of the competence of the public information programs of voluntary agencies.

Determination of standards and methods for the consolidation of local affiliates of national agencies.

Examination of the future role of government in the regulation of voluntary agencies, particularly in the area of standardized disclosure of income and expenditures to the public through uniform accounting and financial reporting.

Dr. Hamlin, the study director, was not particularly enthusiastic about the committee's recommendation for a national commission. He believed that the most appropriate follow-up to the committee's exploratory study would be a series of comprehensive studies which would be "required to classify the role and responsibilities of voluntary agencies." "Specifics, not generalities, are the urgent need," he wrote. "The minds of men in this troubled field can be influenced only by well-documented facts and specific, comprehensible recommendations. The urge to action is insufficient; the *means* of action must also be created."

Dr. Hamlin had earlier suggested six studies, based on problems identified during the exploratory study. The proposed studies concerned issues that in his opinion were not amenable to study by the voluntary agencies themselves, either individually or collectively. Moreover, for the studies to stimulate change it was necessary that recommendations be based on informed judgment and that a plan for continued evaluation of voluntary agencies by the public be developed.

The six issues that the study director had recommended for further study "by a committee of distinguished civic leaders" emerged in the Ad Hoc Committee's report in a somewhat modified form as the aforementioned topics for consideration by the proposed national commission.

Dr. Hamlin urged continued and greater in-depth study because he believed that recommendations that merely suggest that others do certain things "where there were no discernible impartial groups who are in a position to undertake and to complete these difficult, controversial but much-needed means or instruments of action . . . have a hollow ring." He did not regard as feasible or desirable an on-going private mechanism for regulating private agencies. The best that could be done, considering the concept of voluntary endeavor in our society, was to provide the contributing public with tools for periodic evaluation: "The *process* of . . . study may be as important as the final findings and recommendations. The mere fact that study is going on – study directly involving the agencies and requiring their cooperation – creates a stimulus for voluntary agencies to consider and act upon their own problems." This point of view was expressed by the Ad Hoc Committee in its recommendation for the establishment of a national commission: "Since the Ad Hoc Committee believes that periodic assessments have greater impact, especially in controversial areas, than permanent evaluating bodies whose effectiveness tends to diminish with time, it recommends that the Commission should be created initially for a period of no more than five years."[7]

During the months following the publication of the Ad Hoc Committee report, committee members Lindsley Kimball, James A. Linen, president of Time, Inc., and Marion B. Folsom, director of Eastman Kodak Company and former Secretary of Health, Education and Welfare, discussed the possibility of forming the proposed national commission. They decided that the cooperation of the organizations comprising the voluntary health and welfare field would be essential to the success of the new commission. Accordingly, the proposal was explored with the presidents and chief executives of the three national membership organizations to which most of the major voluntary agencies belonged: United Community Funds and Councils of America (now the United Way of America), the National Social Welfare Assembly (now the National Assembly of National Voluntary Health and Social Welfare Organizations), and the National Health Council.

On September 22, 1961, the board of United Community Funds and Councils of America approved a resolution supporting such a commission:

> That the Board of Directors express its appreciation to the members of the Ad Hoc Committee on Voluntary Health and Welfare Agencies in the United States and to the Rockefeller Foundation for the exploratory work which has been done.

> Further, that the Board express its agreement with the two principal recommendations of the Committee report, namely: The appointment and financing of a National Commission on Voluntary Health and Welfare Agencies, and the development of uniform accounting and financial reporting for voluntary agencies.

At its annual meeting on December 13, 1961, the National Welfare Assembly responded as follows:

> The Assembly supports the establishment of a National Citizens Commission on Voluntary Health and Welfare, provided that such a Commission be an independent body not under any single auspice but involving and reflecting the interests of the parties of major concern including the giving public and such national bodies as the National Social Welfare Assembly, the National Health Council, and United Community Funds and Councils of America.
>
> The Assembly authorizes its President to participate in the establishment of such a National Citizens Commission.

And on May 25, 1962, the National Health Council backed the plan in this resolution:

> 1) The Commission should have an essential purpose of a positive nature, namely, to strengthen such voluntary agencies and increase public support; 2) consist of a membership equally representative of health, welfare, and the general public interest; 3) function in an advisory rather than a regulatory capacity; 4) utilize the experience and resources of the National Social Welfare Assembly, the National Health Council, in the planning and execution of studies and in the implementation of such recommendations as may develop from these studies; 5) assist these agencies in strengthening their organizations and achieving their purposes; 6) avoid over-lap of program and objectives with the National Commission on Community Health Services; 7) refrain from promotion of federated fund-raising for those agencies which do not choose to adopt this method; 8) function for a limited period; and the Board, therefore, recommends that the President of the Council accept membership on the now-forming commission, and participate in its activities.[8]

The National Health Council's reservations about the proposal, evident in the conditions set forth in the resolution, were expressed by George Bugbee, president of the council, in the following excerpt from a letter to Dr. Hamlin on October 18, 1962:

> I am quite familiar with your proposal for a national commission and I think it likely that such a commission will be established; though, I have been concerned that such an organization, with the best of intention, will nonetheless inevitably have a membership drawn largely from the same individuals who have been sufficiently concerned with national health problems to devote great time, effort and money through individual voluntary health agencies. Whether bringing together such a group — which will have no responsibility for operating an effective voluntary agency — will correct some of the inevitable concomitants in our voluntary health field is yet to be proven. Certainly, they can have no better intent than has been the predominant motive in these agencies. Unless such a commission proceeds very wisely, it can easily generate public criticism, which will be only a limited handicap to those of bad intent but can seriously affect public confidence in the voluntary health movement.
>
> Throughout my career, which has largely consisted of work in the voluntary health field, I have been continually impressed by the tendency of groups of able

individuals — unfamiliar with the details of specific agencies within the field — to assume that governing boards are failing to operate intelligently and may, indeed, not be performing to the best of their ability in promoting the common good. This seems to be an inherent reaction and I have been guilty of it myself.

Through the years I have been very much involved in the national accreditation of Blue Cross plans and in the activities of the Joint Commission on the Accreditation of Hospitals and in other voluntary coordinating and accrediting ventures. Time after time those charged with this responsibility nationally, without full information, have been ready to conclude that the voluntary efforts of other public-spirited individuals involved with the management of important local and state voluntary health agencies were performing badly. Yet, with few exceptions, careful investigation and consultation with those who have primary responsibility indicated that the governing body and administration were well acquainted with its problems, and were moving to cope with them as best they were able with the resources in money, time and experience which they had.

From what I have said, you will understand that by and large I have great respect for the good intent and performance of the thousands of people who voluntarily participate in our voluntary health agencies. Their record of performance supports this judgment and it is my own conviction that the more one investigates the problems with which they contend, the dedication they demonstrate and the plans they develop one is impressed with the integrity and with what has been accomplished.

With these expressions of support from the organizations in the field, Kimball, Linen and Folsom convened a group on April 24, 1962, to consider this question: "Is any useful purpose to be served in creating a new Committee, and if so, what does it conceive its function to be and how may it most constructively proceed?" The group included two other members of the Ad Hoc Committee and the presidents of seven organizations having a coordinating and planning function vis-a-vis voluntary health and welfare organizations: United Community Funds and Councils of America, the National Social Welfare Assembly, National Health Council, Council of Jewish Federations and Welfare Funds, Inc., National Conference of Catholic Charities, Community Services Committee of the AFL-CIO, and Advertising Council. The chairman of a committee of the American Medical Association concerned with voluntary health agencies also attended.

The group reviewed a proposed "frame of reference" for a "New National Commission on the Voluntary Health and Welfare Agencies," decided to continue to explore the establishment of a commission and to serve as the nucleus of the commission. Linen was elected to serve as chairman, at least until the new organization got underway and was staffed and financed. Subcommittees were appointed to suggest other suitable candidates for membership on the commission and to provide suggestions for initial staffing.

The group was reconvened by Linen on June 22, 1962, at which time it was agreed that the commission would comprise 20 to 25 members, including, in addition to the carry-overs from the Ad Hoc Committee and the presidents of the coordinating groups, the "Secretary of Health, Education and Welfare; 3 businessmen; 1 Chamber of Commerce; 1 Communicator; 1 additional labor man; 2 Medical men; 1 Negro; 1 Woman . . . Consideration might also be given to adding 1 educator and 1 lawyer." An extensive roster of individuals within each of these categories had been assembled.

The inclusion of the presidents of the coordinating groups represented a departure from the recommendations of the Ad Hoc Committee report, which had described the members of the proposed commission as "citizens who reflect the public interest rather than partisan viewpoints." When serving as president of an organization, even though it is an organization dedicated sincerely and wholeheartedly to the public good, an individual, however public-spirited, is inevitably partisan to the interests of the organization. However, as stated earlier, the self-appointed initiators of the commission plan believed that the cooperation of the coordinating organizations in the field was essential to success. The price of this cooperation was the participation of these organizations in the selection of commission members and minority representation on the commission of their presidents. In a recent discussion with two of the initiators, Kimball and Linen, this move was not labeled as a fatal mistake, but in expressing an opinion in favor of the viability of such a commission today, they agreed that it should be fully independent of the groups it undertakes to assist.

During the months following the June 22 meeting, the subcommittee on staff had extensive discussions with Leonard W. Mayo, a distinguished educator and social worker who was then executive director of the Association for the Aid of Crippled Children in New York City. Mayo, in his long and successful career, had been chairman of President Kennedy's Commission on Mental Retardation, president of the National Conference on Social Work, chairman of the Commission on Chronic Illness, vice-president of Western Reserve University, and a leader in countless other activities.

Mayo, who was deeply interested in the potential of the proposed commission, agreed to take a temporary leave from his current duties to work with the organizing group to develop and refine a plan for the commission. Crucial to his decision was the presence of a serious mandate from two or more major foundations and assurance from three of the coordinating groups – the National Social Welfare Assembly, the United Community Funds and Councils, and the National Health Council – that the plan had their backing. Mayo stated that he "was just as much interested in the mandate from the foundations as . . . in their money, for without real conviction and moral backing of some groups not immediately concerned but representative of the American people in general, I feel we would be in a less strong position than otherwise."

To finance Mayo's work, Kimball made funds available from the balance of the Rockefeller Foundation grant for the Ad Hoc Committee study. The members of the organizing group met with Mayo on May 1, 1963, to discuss the "frame of reference" he had developed which would be used to recruit the additional members and to obtain financial support. After the meeting, Mayo refined the plan with the help of the many key individuals in agencies, foundations, and governmental circles where he was widely known and respected.

By January 1, 1964, the proposal for the national commission read as follows:

> 1. *Philosophy and Purpose of the Proposed Commission*
>
> The general purposes of the Commission are to encourage increased participation of the American people in voluntary health and welfare organizations; to foster more effective operations and programs under voluntary auspices; to strengthen the leadership of such agencies and extend and deepen the influence of the entire voluntary effort in the nation.
>
> The Commission is concerned not only with problems of the immediate present, but with the future of the voluntary movement and with voluntary agencies per se, their relations with each other and with corresponding services and programs under governmental auspices; and with the quality of services they render and the extent to which the contributor is receiving full value for his dollar.
>
> The Commission does not intend to establish a new agency, nor does it consider itself an agency in the orthodox sense. It will not appraise or pass judgment upon specific agencies as such, nor espouse any one method of fund raising; it will perform a critical and advisory rather than a regulatory function.
>
> Though the increasing number of voluntary agencies, particularly in the health field is a matter of concern, the Commission recognizes the right of citizens to organize and pursue appropriate objectives in the public interest; in like manner

it recognizes the right of the public, if it is asked for funds to support the program of a private group, to have full and objective data as to the need for the program espoused, assurance of competent and responsible board and staff leadership, and adequate fiscal policy and operating standards.

In sum, the Commission proposes to analyze and study basic problems of far-reaching importance to voluntary health and welfare services and to the public; and to develop recommendations and guidelines that can be influential in shaping policy. In so doing it will avoid duplicating studies being conducted by other groups; and in implementing its own studies it will, insofar as possible, utilize and cooperate with existing facilities, particularly the national coordinating and planning bodies in health and welfare, the recently established National Commission on Community Health Services and other appropriate groups.

2. *General Methods of Operation of the Proposed Commission*

In its operations the Commission will regard itself as an instrumentality for overviewing the needs and problems of voluntary health and welfare services; for bringing contributors and agencies into closer understanding and cooperative endeavor, for strengthening existing voluntary planning bodies and agencies; and for clarifying the respective and joint roles of voluntary and governmental programs.

The Commission will attempt to serve as a catalyst for appropriate action in the light of its findings and recommendations and in relation to other studies with which it wishes to associate itself. In doing so, it will recognize an equal obligation to the agencies involved, to those served by them and to the contributor. To these ends the Commission will work cooperatively with agencies and groups of agencies, both voluntary and governmental.

The Commission would employ the following methods, among others, in the process of obtaining and weighing opinion, stimulating new ideas and encouraging the development of guidelines and policy:

a) *Field visits* to selected portions of the country in order to observe at firsthand how critical problems in program development and financing are being met and to study the relationships between voluntary and governmental agencies in planning and coordination.

b) *Public hearings*. It would be important for the staff to visit key areas of the country on a scheduled basis and conduct hearings to which people from the local community and the state would be invited to express their views on the present role and status of voluntary health and welfare agencies and their future role.

c) *Small informal conferences* or consultations should be held in New York City and elsewhere to which lay and professional leaders would be invited to confer with the staff and members of the Commission on specific topics or problems submitted to them in advance in the form of tentative 'position papers' for their considered opinions.

It would be important for the Commission to study the functions of the National Budget Committee, a creature of the National Social Welfare Assembly and United Community Funds and Councils, which reviews and makes recommendations concerning the budgets of many of the national voluntary agencies; and the function and potential of the National Information Bureau, which provides information on voluntary social and welfare agencies for the benefit of prospective contributors, should also be studied. (See Chapters V and III, respectively, of this report for description of the National Budget Committee and the National Information Bureau.)

The functions of the National Budget Committee and the National Information Bureau suggest that the Commission should study intensively the wisdom, practicality, and feasibility of central reporting on both finances and program criteria or standards for agency operations, and the value of a well-conceived and administered plan of accreditation. It should be noted that the National Budget Committee, the National Health Council, and the National Social Welfare Assembly have taken definite steps to establish reasonable standards of operation for the national agencies in their respective orbits of influence and that their efforts are being met with an encouraging response. (See Chapter VI for discussion of the National Health Council's standard-setting efforts.)

The Commission would conduct its work through subcommittees or task forces aided by a small but highly competent professional staff; participation in such groups should not necessarily be confined to Commission members.

To whatever extent is feasible and practical, agencies and coordinating groups would be asked to assist the Commission in studying the problems that come before it, discuss its findings, offer suggestions, and react to its recommendations as they develop.

While the Commission should not by any means be a protege of any national organization or group it must not be isolated from key groups in the field; it should, in fact, establish and maintain direct channels of communication with them. To be influential with the contributor and the public at large, however, it must retain complete independence and be free to speak on its own and with its own voice.

3. *Special Studies of the Proposed Commission*

Through its own work and through studies it would stimulate and help to finance, the Commission could gain a great deal of data of basic value to the public and to the agencies which could be released from time to time as brief reports and informative statements. In addition, agencies should be encouraged to conduct studies of their own programs with expert assistance from outside their own ranks.

The following types of studies as originally suggested by the Ad Hoc Citizens' Committee should be considered by the Commission:

a) Public understanding of voluntary health and welfare agencies.

   Such a study would gather information on the degree and extent of understanding on the part of different segments of the public (large and small contributors in industry, business, and labor, etc.) with respect to the performance, the usefulness, and the role of voluntary health and welfare agencies.

b) A formulation of criteria for the evaluation of voluntary health and welfare agencies.

   This study would draw upon current national agency interest and experience in the evaluation of performance and develop criteria that could be used by national and local agencies in assessing their effectiveness.

c) Studies of planning and coordination as currently conducted by national and local health and welfare organizations.

The objectives of such studies in the words of the report of the Ad Hoc Citizens' Committee would be:

(1) To examine *existing* methods of cooperative planning and inter-agency organization at all levels.

(2) To prepare *case studies* of good planning methods now used by communities and voluntary agencies.

(3) To formulate *common principles* of sound planning.

(4) To develop *guides* and *procedures* by which these principles could be effectively used by communities, voluntary agencies, and other private and governmental groups.

d) Studies of methods of financing.

This would constitute one of the most important and critical tasks of the Commission. Information should be carefully compiled on current fund raising methods; criteria as to what constitutes a 'successful campaign' should be formulated; management methods and the philosophy and procedure of the distribution of funds should be studied and guidelines drawn up for the benefit of the contributor and the community at large.

The above list suggests the type of study that would be considered by the Commission and which it would conduct or cause to be conducted. Others, and the most effective approaches to those listed, would be suggested by knowledgeable individuals and organizations and planned in detail by the staff with the assistance of competent social scientists.

The Commission should be receptive to a discussion or study of any problems brought to it by voluntary health and welfare agencies and other responsible groups and individuals provided they appeared to be of importance and concern to the agencies and the public.

A number of studies are now being conducted by national bodies and local groups with which the Commission should keep in touch and from which it could gain a great deal by way of grist for its own mill. . . .studies or collection of data that can appropriately and effectively be carried on by the national voluntary organizations, or major coordinating or professional health or welfare groups should be undertaken by them, thus avoiding duplication of effort and expense. The Commission should keep in touch with such studies and have access to the findings for its own consideration.

One of the most important and far-reaching responsibilities of the Commission should be to insure that a study is made (preferably under its own auspices) of the development, present status, and the future of the volunteer movement in our society with special reference not only to its expression in health and welfare activities but in relation to the manifestations and underlying causes of basic social problems. A study of this kind would go to the heart of many questions relating to the role of the individual citizen in an era when it is no longer a simple matter to be a 'good neighbor.' A work of substance and import could be developed around the theme of the individual as the well-spring of a free society and the problems and challenges he faces in maintaining his identity and making his contribution in the space age.

> 4. *Implementation of Recommendations and Findings of the Proposed Commission*
>
> Plans for adequate follow-up of the Commission's work should be carefully 'built in' at the outset. Provisions should be made for involving at an early date the major groups that should be responsive to its recommendations and findings. The Commission must sustain the kind of relations with key groups in the field that will help to insure their continued interest and cooperation in bringing about steady and constructive change.
>
> In view of the problems involved and the need for deliberation and study, the Commission will in all probability find it necessary to continue for a period of at least three years. However, if it becomes clear at any time that it cannot serve a useful purpose, it can dissolve. If an extension beyond three years appears to be warranted, that can be determined at a later date. In any event, it is essential that sufficient time be allowed for a thoughtful exploration of the most important problems affecting the future of health and welfare services in the country, and for the formulation of effective plans and practical guidelines designed to strengthen voluntary effort and its impact on governmental policy.
>
> There have been encouraging responses on the part of many national health and welfare agencies in recent months as the possibility of activating the National Commission on Voluntary Agencies became known. This may be due in part to fear of what the future may hold, but it is based too on the desire of both lay and professional leaders to analyze the services of their agencies from the point of view of quality, impact on current problems, relationship to the public services, and the desire to tool up for the new challenges of this era. Whatever the cause, or causes, there are substantial indications of new interest and awakened concern. This, plus the urgency created by the critical problems of health and welfare that are facing the American people, presents a strong case for immediate and thoughtful study and action.

On March 30, 1964, Mayo returned to his duties with the Association for the Aid of Crippled Children. The group comprising the nucleus of the proposed commission never convened again. No formal approaches were made to foundations for support despite the implication that Mayo undertook the assignment with the assurance that there was "a serious mandate from one or more foundations." In 1964 Mayo considered writing a book to salvage the work he had done. He never wrote that book.

What happened to this five-year effort? There are no files to document the ending of the undertaking. Based on my own close association with the efforts to establish a commission and on subsequent discussions with others who were equally involved, I believe the critical missing factor was central leadership for the new commission – an individual who could and would attract other members in addition to those who had joined because the organizations they headed were vitally concerned and who could muster financial support and provide continuing leadership. Linen was such a person, but he became involved in preparations for the 1964 Presidential campaign. Folsom was also qualified to undertake this task, but the National Health Council and the American Public Health Association persuaded him to accept the chairmanship of the newly formed National Commission on Community Health Services, an organization that focused on a subject of more precise interest to Folsom (the strengthening of the provision and delivery of health services) and that was assured of financing from the W.K. Kellogg Foundation.

So the essential leadership did not emerge, and the proposal died. Linen recently expressed the belief that the outcome would be different today, that it would be much easier to find the "right person" now than it was in 1964 when the corporate world was less committed, concerned, or involved in philanthropic issues.

Interestingly, and significantly, none of the private health and welfare organizations whose support had been sought and obtained made any effort to keep the proposal alive. Even though the objectives of the commission had been revised to accommodate their stipulations that the new organization be "advisory" and not "regulatory" and that its aims include strengthening them as organizations, the National Social Welfare Assembly and the National Health Council and the array of major voluntary organizations that comprised their membership were not disposed to pursue the matter. Nor did United Community Funds and Councils, the originator of the entire project, make an effort to salvage it.

It may well be that the proposal was not practical, that it could not have been funded or would not have functioned successfully. Perhaps these were the reasons why no leadership emerged. There can be no definitive answer, since the proposal was never executed. Clearly, Kimball and Linen think it is a viable idea today, provided the commission is not self-appointed, is not "permanent," and is free of entangling alliances.

Action on Recommendation for Development of Uniform Accounting and Financial Reporting for Voluntary Agencies

Far different in its outcome was the second major recommendation of the report of the Ad Hoc Committee. The accomplishments of voluntary health and welfare agencies in developing and implementing uniform financial reporting illustrate how the private sector, given a tangible goal and convinced of its importance, can mobilize and move. Tremendous strides have been made in the 13 years since the Ad Hoc Committee called for a uniform reporting system.

In recommending the development of standardized accounting and uniform financial reporting by voluntary agencies, the Ad Hoc Committee report cited the following benefits that could derive from such a project:

> to help answer some of the important questions the public is now asking about voluntary agencies. Comparisons of agencies through their financial statements—an almost impossible task at present—would then be routinely possible. A standard method for explaining agency income and expenditures would show more clearly how agencies obtain and use their funds.
>
> to give voluntary agencies valuable new information, data with allocations to program functions would yield better information on costs. Agency management could then make better decisions about programs and policies.
>
> to reduce the debate over federated versus independent fund raising. The public would have accurate information on what is now a battlefield of uncertain statistics.
>
> uniform accounting and financial reporting, if developed and administered properly, would have a profound and beneficial influence on the voluntary agency movement. It is potentially the most important method for obtaining adequate information about voluntary agencies, for the benefit of both the agencies and the American public.

The report further indicated that the executive committee of the American Institute of Certified Public Accountants, a major membership organization in the accounting industry, was prepared to undertake the project "subject to the receipt of a formal request and adequate financing." The institute had appointed a committee of "outstanding accountants," presumably in anticipation of undertaking the project; one of the eight largest member accounting firms would be retained to provide the skilled staff needed. Two years would be required to develop the uniform accounting and financial reporting for use of individual voluntary agencies. Additional time might be required to formulate methods to enable non-agency groups to apply the standardized reports.

The Ad Hoc Committee observed: "It is important that methods be developed to enable various outside groups to review voluntary agency application of uniform accounting and financial reporting. Periodic audits by accounting firms retained by the agencies would probably not be sufficient to ensure direct disclosure of finances to the public."

Earlier, in 1956, a committee representing the voluntary agencies that were members of the National Health Council had undertaken an exploration of uniform financial accounting. The impetus for this was the newly enacted legislation in New York that empowered the New York State Department of Social Welfare to require certain reports from philanthropic organizations. In attempting to work with state officials on the development of mutually satisfactory reporting procedures and forms, National Health Council member agencies discovered that they were unable to communicate among themselves on accounting and financial reporting matters because of the lack of common definitions and terminology. Obviously, if the agencies could not communicate among themselves, they could not communicate clearly and effectively with outside groups such as state and local government regulatory agencies. This is to say nothing of the confusion the agencies' public financial reports must be creating for interested citizens and potential contributors who attempted to compare the financial reports.

The National Health Council's committee had asked the American Institute of Certified Public Accountants to undertake the project for the council. The institute, however, believed that the council provided a more appropriate mechanism for the inquiry and suggested Howard A. Withey, a partner in Peat, Marwick, Mitchell & Co., as chairman for the project. Withey had been prominently associated with the development of accounting and reporting standards for colleges and universities.

The project moved slowly because the council was unable to obtain the necessary financial support from outside sources. Finally, the participating member organizations provided limited financing for a modest project, and in 1960 an accountant was employed as staff to the committee. Most of the committee members were comptrollers employed by the participating agencies. In addition to Withey, Joseph Taggart, dean of the Graduate School of Business Administration at New York University, and John J. Black, assistant treasurer of International Business Machines Corporation, served as "outside" members of the committee.

The National Health Council had already prepared the first draft of its proposed accounting and reporting guide when the Ad Hoc Committee published its report recommending a similar project, but one that would be done for both health and welfare agencies and under the auspices of the American Institute of Certified Public Accountants.

Officials of the council were understandably pleased with the apparent timeliness of their project. But they were also concerned that public response to the forthcoming guide would be adversely affected by the limitation of the project's scope and development to health agencies.

The executive director of the council was convinced that the council committee's work represented a major step forward. Furthermore, he believed that to obtain the cooperation of the member voluntary health agencies in the vital job of implementing the new reporting system it was essential that the leadership of the National Health Council express confidence and trust in the project. It was doubted that a committee from the accounting industry could generate this cooperation. While the council's leadership had not been very effective in other program areas, the executive director felt that the organization had some chance of accomplishing the mission outlined in the Ad Hoc Committee's report, especially since the Accounting Institute's prospects for success were even less promising.

Since the Ad Hoc Committee report was also directed to voluntary welfare agencies and since these groups were not participants in the National Health Council's project, discussions were initiated between the council and the National Social Welfare Assembly, the counterpart organization in the voluntary social welfare field. The executive directors of the two organizations, who had worked together on many issues of common concern in the voluntary field, shared the belief that prospects for successful development and subsequent acceptance of financial reporting guidelines would be greatly strengthened if the project were endorsed by the leadership of both national coordinating groups.

Accordingly, a joint liaison committee of top officers of the council and the assembly worked out a proposal that envisioned completion of the council's accounting guide for health agencies and concurrent development of a similar guide for social welfare agencies by the assembly. One of the assembly's key members was the United Community Funds and Councils of America; UCFCA would be an essential participant in the assembly project and could use the network of United Funds throughout the country to gain acceptance and cooperation of community agencies.

The American Institute of Certified Public Accountants was asked to join as a third sponsor of the project but declined to be formally involved, an action that was contrary to the implication in the Ad Hoc Committee report that the institute was prepared to undertake the project. The executive vice president of the institute explained that the decision not to become officially associated with the project reflected disagreement within the organization on the subject of developing accounting principles for the nonprofit field. AICPA did volunteer a list of prominent accountants, representing its major member firms, from which the council and the assembly could choose project committee members and whose participation should result in viable and acceptable accounting and reporting guides.

The council and the assembly then approached the Rockefeller Foundation with a request for financial support to enable the two coordinating agencies to accomplish the recommendation of the Ad Hoc Committee. Although Lindsley Kimball was no longer with the foundation, he was instrumental in securing a decision by both the Rockefeller Foundation and the Avalon Foundation (now part of the Mellon Foundation) to support the proposal. It was a testament of faith in the ability of the voluntary sector to mobilize support for and carry out a project designed to improve the field and ultimately to benefit the public.

Dr. Hamlin, who believed so strongly in the need for uniform accounting and public financial reporting, was openly critical of the plans for the project. He made several speeches on the subject in which he expressed little faith in the ability of the voluntary sector to set standards for itself and to make an effective effort to apply such standards. He was in favor of the "impartiality" which AICPA could bring to leadership of the project. The council and the assembly, however, had discovered that AICPA was no more influential in its field as a membership organization than the council and the assembly. In private correspondence with the council's chief executive, Dr. Hamlin expressed the hope that the council and the assembly would succeed, though he feared they would not, and stated that his publicly announced skepticism about the project might well stimulate better efforts than in the past.

Because of the impact of the Ad Hoc Committee report, the National Health Council's earlier limited project to develop accounting and reporting standards was now incorporated into a much broader project embracing both voluntary health and welfare agencies and with adequate financial support to retain the best possible staff services to assure a professionally sound job. Furthermore, the voluntary agencies and the accounting firms that serviced them not only had a stake in the development of new standards and guidelines but also could foresee that their receptivity to the new standards would be positively influenced by the widely publicized and approved recommendation of the Ad Hoc Committee. The foundation financing gave the council and the assembly some degree of independence from their dues-paying member organizations in conducting the project.

Development and Publication of the Standards

The many diverse interests involved in the undertaking were brought together in the Project Advisory Committee, appointed by the presidents of the council and the assembly in January 1963. Working under the chairmanship of the late Hugh Jackson, president of the Better Business Bureau of Metropolitan New York and a widely respected volunteer who for a number of years had been an officer and board member of UCFCA, the Project Advisory Committee completed work on the standards late in 1963. The standards were then approved by the boards of directors of the two sponsoring organizations.

Technical staff service was purchased from the accounting firm of Peat, Marwick, Mitchell & Co. The decision to identify the committee's work with a major accounting firm was questioned by those who thought that this might prejudice the acceptance of the standards by organizations that used the services of competing accounting firms. However, the major firms were the only source of the type of skilled professional staff needed for the project. The Project Advisory Committee included in its membership representatives of some of Peat, Marwick, Mitchell & Co.'s competitor firms in the hope that any criticism of vested interest in authorship could be offset.

Six outstanding CPAs were selected to represent the industry on the committee. (One of the appointees was the chairman of the AICPA's Committee on Relations with Charitable Organizations.) Copies of all materials relating to the project were sent to the AICPA's director of research for review and comment.

The committee's final report, *Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations*, was published in 1964. By 1974, 19,000 copies had been distributed. The publication, which proved to be a landmark accomplishment for voluntary effort, superseded the National Health Council's 1962 publication. It has provided the basic structure and information for innumerable other publications such as specific accounting manuals for internal use by voluntary agencies and groups of these agencies. Among the standards it promulgated for public financial reporting for voluntary agencies were the accrual basis of accounting, reporting of financial activities on a functional basis, and combined national reporting for all affiliated groups. It also developed a series of reporting forms that would facilitate the consolidation of financial information for public convenience and clarity. Expenditures were classified in two main categories: program services (definitions for which reporting agencies would develop for their specific field of interest) and supporting services (comprising two sub-categories, "management and general" and "fund raising"). This second expenditure category was defined as precisely as possible, given the lack of available information on these types of activities and the wide diversity of practice among the voluntary agencies.

On the always troublesome subject of the relationship between the amount of contributions and the cost of raising and collecting contributions the publication stated that "if it were possible to prescribe a single basis for comparison, or method of calculating a fund-raising cost ratio that would be applicable uniformly, such efforts would be most useful. Facts do not appear, however, to justify expectation that this can be done . . . a great deal of caution (should) be exercised by individuals or groups who attempt comparative evaluations of voluntary agencies' fund-raising costs, or who attempt to devise standard methods of calculating fund-raising cost percentages or to set ceilings for them."

Implementation of the Standards

Even before the report was completed it became clear to the two sponsoring organizations that much of the value of the work in developing the *Standards* would be lost if they did not make an effort to encourage awareness and acceptance of the *Standards* by the contributing public, which was ultimately to benefit, and by the voluntary health and welfare agencies that would be directly affected. These agencies included not only the national organizations affiliated with the assembly and council, but also the vast number of state, regional, and local organizations not affiliated with any specific national agency.

Beginning February 1, 1965, the two sponsoring organizations undertook an implementation project. Support was generously given by the Rockefeller Foundation, Kellogg Foundation, Russell Sage Foundation, the New York Foundation, the W. Alton Jones Foundation, and the Rubicon Foundation. The project covered the following phases: the development of a guide adapted from the *Standards* for the use of regulatory and licensing agencies; work with the 37 participating national agencies of the National Social Welfare Assembly and with the 17 member agencies of the National Health Council to place the agencies and their local affiliates in a position to report to the public in accordance with the *Standards;* work with United Community Funds and Councils to make the *Standards* available to local community chests and United Funds; and work with local interest groups to promote and interpret the *Standards* to those voluntary agencies not reached through other means. Technical assistance for the project was provided by Peat, Marwick, Mitchell & Co.

Promotion of the *Standards* on such a broad scale proved to be an extensive undertaking. Although total compliance among all participating organizations was not fully realized by the end of the project in 1967, the results were substantial.

The implementation project was extremely ambitious, especially since its aim was adoption of a common reporting system by a highly diverse group of private voluntary organizations which had little in common beyond their interest in health and welfare, their voluntary status, and their dependence on public contributions. Some of the major national organizations were not receptive to adoption of the *Standards*, and not all of the potential allies among regulatory and standard-setting bodies were promoting adoption. In addition, the public was not fully aware of the existence of the *Standards*.

Establishment of Ongoing Promotion and Supervision of Public Financial Reporting

The council and the assembly concluded that there must be continuity of effort over an extended period of time if the substantial gains that had already been made were to be preserved. The sponsoring organizations were mindful of efforts in the 1940s and 1950s to establish uniform standards in the field of higher education: The lack of continuity in promoting standards and especially the lack of a central body to oversee conformity to accepted and uniform standards led to such diversity of practice that the ultimate goal of uniform reporting was lost until recent years.

The same problem confronted the voluntary health and welfare field in 1967. The sponsors predicted that if some type of coordinated technical assistance program were not provided to ensure uniform implementation, the essential value of the *Standards* would be lost, together with the expenditure of effort and money over the past decade.

Accordingly, the council and the assembly proposed to create a center for the promotion of uniform accounting standards to do the following:

1. Extend acceptance and use of the *Standards* among corporate foundation groups, philanthropic foundations, governmental agencies, and the accounting profession; continue efforts to increase conformity to the *Standards* by organizations not conforming;

2. Establish a central national technical service to

    a. Review manuals, instructions or other appropriate documentation submitted by organizations to determine if the established definitions and procedures were in substantial conformity with the *Standards* in all material respects;

b. Enhance the ability of national and local health and welfare organizations, regulatory bodies, central fund-raising and planning groups, and other interested bodies to adopt, install, and implement the *Standards;*

c. Interpret the *Standards* and their use to interested groups and individuals in local communities;

d. Create a compendium of proper interpretation of the *Standards* to serve as a source document for agencies implementing the *Standards* and as a guide for the accounting profession as it conducted its audit function; and

e. Provide a mechanism through which appropriate revision of the *Standards* could be accomplished, when needed.

The cost of the proposed center for a period of five years (1968-72) was estimated at about $750,000. It was hoped that corporate foundations would contribute the nucleus of support, with private foundations assuming some share of the operating costs. The voluntary organizations in the field were not a realistic source of basic financing since (1) the internal implementation of a new system of accounting and reporting would require new expenditures by each agency, thus making them reluctant to incur additional expense for a central monitoring organization, and (2) voluntary organizations that had not shown an interest in adopting the *Standards* could hardly be expected to finance a mechanism intended to encourage conformity to those standards.

The hope that influential corporate foundations would provide financial support for the center was not realized. Representatives of key corporate foundations expressed the opinion that consideration of revisions of the *Standards* and "policing" were logical functions of the accounting profession. They suggested that if the sponsors could obtain endorsement of the *Standards* from the American Institute of Certified Public Accountants, accounting firms could then be persuaded to assume the "policing" of the *Standards.* This plan had originally been proposed by Dr. Hamlin, the study director for the Ad Hoc Committee, and had been pursued by the council and the assembly, but with no success.

During the years that the council and assembly were engaged in their project, the Accounting Principles Board of the AICPA continued to work on the formulation of "Generally Accepted Accounting Principles for Nonprofit Organizations." AICPA's inability to resolve fundamental differences of opinion among its members on technical accounting matters adversely affected efforts to promote use of the *Standards.* The voluntary organizations that were reluctant to adopt the *Standards* and knew of the differences of opinion among accountants could cite these unresolved issues as a reason for not adopting them.

The problem was further compounded in October 1966 when the AICPA's Committee on Relations with Nonprofit Organizations published a guide for accountants performing audits for voluntary health and welfare organizations. While this guide did not endorse the *Standards,* auditors using the guide were free to audit the accounts of their client organizations in accordance with the *Standards.* The introduction to the guide included the following statement about the *Standards:* "The prescribed standard accounting and reporting practices (i.e., *Standards)* will, if consistently applied, result in reducing the variety of reporting practices . . ."

When assembly and council representatives, acting on the corporate foundation group's recommendations, met with officials of the AICPA, they were advised that before the institute could approve and endorse the *Standards* some revisions would have to be made. An ad hoc group of the AICPA was appointed to meet with representatives of the assembly, council, and United Community Funds and Councils of America to agree on the necessary revisions. The results of these negotiations were issued October 1969 in a report of the AICPA Ad Hoc Group on Voluntary Health and Welfare Organizations. The AICPA took the following action on the report of its ad hoc group:

> After further review of the report of our three-man ad hoc group on voluntary health and welfare organizations, we have concluded that the American Institute is not in a position at this time to approve either the ad hoc group's report or your publication, *Standards* . . . An amendment of the guide would require the same procedures as those followed in issuing the original guide, and this would take some time. Nevertheless, we are willing to appoint another committee to undertake a study of problem areas with the intent to produce a revised guide.

Discouraged by six years of seemingly fruitless effort, but recognizing the vital importance of endorsement by the accounting industry, the council and the assembly accepted the AICPA's offer to establish another study committee.

The council and the assembly were, however, skeptical about the chances of accomplishing their objectives with AICPA and in 1972 formed a joint liaison committee with the United Way of America (successor to UCFCA) to work on specific plans to encourage and facilitate implementation of the *Standards* throughout the country, adjudicate questions concerning interpretation of the *Standards*, and advise the assembly and council's boards on any changes in the *Standards* that might be needed.

The first major undertaking of the Joint Liaison Committee was to work closely and compatibly with a new AICPA Committee on Voluntary Health and Welfare Organizations. This effort resulted in the September 1973 publication of the AICPA Industry Audit Guide, *Audits of Voluntary Health and Welfare Organizations.* In the preface to its publication, the AICPA notes that the principles it recommends are in most instances compatible with those set forth in the *Standards.* The council, the assembly, and the United Way subsequently revised the *Standards*, and in the fall of 1974 published a new version that achieves the maximum uniformity possible between the two complementary publications.

Thus by 1974 the voluntary sector had come a long way towards accomplishment of one of the two major recommendations of the 1961 Ad Hoc Committee report. Not only did the voluntary organizations succeed in developing standards that are acceptable to both the voluntary health and welfare fields and the accounting industry, but significant progress has been made in implementing the standards:

1. All national voluntary health member agencies of the National Health Council have adopted the *Standards*, developed accounting manuals, and are implementing them among their more than 11,000 regional, state, and local affiliates throughout the country. The National Assembly of National Voluntary Health and Social Welfare Organizations – successor to the National Assembly for Social Policy and Development – expects its associated national organizations and their state and local affiliates will provide financial reports in accordance with the *Standards* in the welfare field for which the *Standards* apply.

2. The United Way of America required that all local and state United Way organizations report to the public according to the *Standards* by 1973 (for 1972 activities).

3. The United States Civil Service Commission, in its administration of the Combined Federal Campaign Plan, requires certification of conformity to the *Standards* at all levels of operation by health and social welfare organizations as a condition for participation in the plan and, thus, in solicitation in federal establishments.

4. State laws and local ordinances regulating solicitations of the public by charitable organizations increasingly encourage implementation of the *Standards* by incorporation of comparable reporting requirements as part of regulatory laws and implementing regulations. Governmental regulatory reporting requirements consistent with the *Standards* are in use in New York, Pennsylvania, Illinois and in urban areas such as Chicago, St. Louis, Los Angeles, and Oklahoma City, to mention only a few. In an effort to further encourage reporting requirements by state and local laws and ordinances consistent with the *Standards* so as to reduce duplicate reporting and

added administrative costs, the National Health Council in 1971 distributed to local and state regulatory authorities a revision of an earlier council publication, *Viewpoints on State and Local Legislation Regulating Solicitation of Funds from the Public.* The uniform financial reporting forms and instructions for use by state and local regulatory bodies presented in the appendix of *Viewpoints* are consistent with the *Standards.* These forms reflect the 1973 AICPA audit guide and the 1974 revision of the *Standards.*

5. The U.S. Department of Health, Education and Welfare has adopted the *Standards* for developing indirect cost rates for voluntary health and social welfare agencies as recipients of HEW grants and contracts.

6. The 1969 Tax Reform Act made it mandatory for all 501(c) (3) organizations to file annual reports with the U.S. Treasury Department. The National Health Council and the National Assembly recommended that the form used by New York State Department of Social Welfare, Charitable Registration Bureau, for financial report (DSS-497), which is consistent with the *Standards,* be adopted by the IRS for this purpose for those 501(c) (3) agencies that must report to both New York and the Internal Revenue Service. The Treasury Department ruled that New York State Form DSS-497 may be used as part 2 of the current 990-A form for reporting to IRS for 1972 and subsequent fiscal periods.

7. The National Information Bureau is currently using the *Standards* in its analysis of health and welfare agencies to determine which agencies meet NIB requirements.

8. The National Council on Philanthropy has endorsed the *Standards* and supported their use in accounting and financial reporting to the public and to state and municipal governmental regulatory bodies. The National Council on Philanthropy has recommended that all contributors urge compliance with the *Standards* by voluntary health and welfare organizations.

9. The Council of Better Business Bureaus cites the *Standards* for use with its own recently published standards for its affiliated organizations throughout the country.

The foregoing represents an impressive record of progress resulting in large part from the positive response of the private philanthropic sector to a major recommendation of the Ad Hoc Committee. The moral support and financial backing of the Rockefeller Foundation was crucial in the initial years. The process was slow. Only in 1974 did the accounting industry begin to assume the leadership position envisioned for it by Dr. Hamlin 14 years earlier. Congress or the Internal Revenue Service could probably have accomplished a similar result in less time, but there would not have been the sense of satisfaction that the participating private groups have derived from their own efforts and accomplishments.

Much remains to be done, however. The extent and the various methods of implementation should be concerns of the Commission on Private Philanthropy and Public Needs.

Other Outcomes of the Report of the Ad Hoc Committee

Since the proposed national commission was not established, there was no systematic follow-up of the impact of other recommendations in the Ad Hoc Committee report. Presumably, this would have been done by the national commission.

Undoubtedly, the report had many indirect positive effects on voluntary health and welfare agencies. Two specific results of the Ad Hoc Committee's efforts are identified and discussed later in this report. As a direct result of the Ad Hoc Committee's criticism of the performance of voluntary agencies, the American Foundation for the Blind took leadership in establishing the National Accreditation Council for Agencies Serving the Blind and the Visually Handicapped (see Chapter VII). And the development, adoption, and acceptance of standards of membership by member agencies of the National Health Council was greatly facilitated by the enthusiastic reception of the Ad Hoc Committee's report (see Chapter VI).

III

THE NATIONAL INFORMATION BUREAU

The National Information Bureau performs a unique function in the private sector as a contributor's advisory service. This independent national organization compiles information on a broad range of national groups that appeal to the public for funds and provides its members with reports evaluating the soliciting agencies in terms of NIB standards. Equally important, in the NIB's view, is its mission "to maintain sound standards in . . . (its) . . . field of philanthropy."

The objectives of the organization are described in the following excerpt from its 1973 annual report:

> The NIB recognizes that continued faith on the part of American contributors is essential for the continued existence of our philanthropic organizations and institutions. The contributors' faith in these agencies encompasses faith in their purposes and programs, in their volunteer controlling boards, in their paid staffs, in their financial management, and in their concrete achievements for the improvement of society and of services to people. Without this faith, contributors would no longer give essential support in time and money, and government would be encouraged to discontinue the several vital privileges as permission to serve society and exemption from taxes of both contributions and income.
>
> To insure the continued faith of contributors in philanthropy, all philanthropic organizations, without exception, should live up to the ideals and standards generally expected as fundamental to their responsibility. This is a task for all agencies and all contributors, but it is not enough in itself. Substandard organizations, also embracing the name of philanthropy, must be prevented from destroying the contributors' confidence in philanthropy generally. This involves not only work with voluntary organizations but also with the public and contributors whose support makes their continued existence possible.

The National Information Bureau was organized in 1920 as a result of the chaos resulting from the proliferation of war-relief appeals, both foreign and domestic, during and after World War I. Most communities were highly successful in raising substantial amounts of funds for war-relief purposes, but had no satisfactory system of allocating these funds among the many appeals received. At the behest of the leaders of a number of war-chest communities, the Contributors Information Bureau in New York City, which had been founded in 1882 as a part of the Charity Organization Society, established the National Information Bureau to do nationally what CIB had been doing for local appeals in New York City.

Until World War II, NIB was primarily supported by wealthy individuals who were the principal contributors to philanthropic causes and who needed the services NIB could offer. During and after World War II, corporate contributions to philanthropy grew, and the NIB's executive director, the late D. Paul Reed, successfully promoted NIB's service as a valuable aid to this expanding corporate philanthropy. Much of the organization's growth in program coverage, membership, and income came from

Reed's leadership and the wide respect he enjoyed among corporate contributors and the community federated fund-raising groups (United Funds) that relied so heavily on giving through business organizations.

NIB is a membership corporation with two principal classes of members. Voting members constitute the board of directors, which is limited to a maximum of 27 members. Contributor members – individuals and organizations – join through payment of an annual membership fee. Contributor members are not entitled to attend or to vote at meetings of the board of directors.

NIB does not identify the members of the board, beyond publishing their names on annual reports, stationery, and other official communications, in order to protect them from pressure by organizations wishing to influence the bureau's decisions.

The anonymity of board members has been criticized, especially by national organizations that have received less than favorable judgments by the bureau. Critics claim that they are not permitted to know enough about the board to enable them to assess the competence of the governing body that presumes to judge them. Another frequent complaint is that there should be greater representation of philanthropic organizations on the board. In the bureau's 50th anniversary report, the following statement appears: "In the 1930s, vested interests in the field of national philanthropy obtained sufficient membership on the Board of NIB to partially block the issuance of some negative reports, necessitating a revision in the method of selecting NIB Board members . . ."

The board is self-perpetuating in that no members can be elected unless proposed by the nominating committee of the board. Members serve three-year terms on a staggered basis, and there is no limitation on the number of terms an individual may serve. The current board president, Alexander Lindey of New York, has held this office since 1961. Of the other 19 board members, 15 are residents of New York City or the New York metropolitan area; the remaining are from Illinois, Minnesota, Vermont, and Texas. Most of these individuals are employed by or otherwise associated with corporate foundations or other private foundations. The board also includes corporate executives, an accountant, the head of a fund-raising organization for independent colleges, three attorneys, and several persons who are identified as "consultants." The board averages about three meetings per year; the executive committees usually meet four times during the year. The board appoints the bureau's executive director, who heads a professional staff of 11.

Contributor members include philanthropic foundations, national business corporations, major individual donors, communications media, local chambers of commerce, government agencies that deal with philanthropy, and local United Way organizations in about 2,200 communities. In 1973, 120 of the 200 largest industrial firms in the United States were contributor members.

Contributor members provide most of NIB's income. The minimum annual membership fee for an individual is $15.00 and for a corporation or foundation, $25.00. According to the bureau, memberships are maintained "at these moderate rates to assure that small donors, as well as large, can have access to essential information for wise giving." Many members join at $100 to $1,000 a year and often increase the amount of their annual support as they become better acquainted with the bureau's services. Individual contributor memberships range up to $3,000 or more annually; some foundations and corporations make membership contributions of $4,000 or more per year.

A recent tabulation of sources of NIB income showed that roughly 48 percent of total income is derived from business corporations and their foundations, 21 percent from other foundations, 10 percent from United Way of America, 21 percent from other sources such as individuals, chambers of commerce, and sales of publications. The bureau's budget in 1974 was $210,100; income for the year was expected to meet this figure.

As described earlier, NIB has two principal purposes: to help contributors to give wisely and to maintain standards in the fields of philanthropy it covers. By influencing the decisions of givers the bureau has a potential regulatory effect on philanthropic organizations. Naturally, these organizations want to be presented in the most favorable light, especially to potential major supporters such as large corporations, foundations, and the United Way. (The Advertising Council, as noted in Chapter I, takes "into consideration whether or not any fund-raising organization meets the NIB standards." However, because some wisely supported charities had continued to receive an unfavorable opinion from NIB, the Advertising Council decided that NIB's opinion should not be the sole basis for determining whether a philanthropy should have access to the contributed time and space of the media.)

NIB makes available to contributor members individual reports on about 500 national and international agencies. Although some of these organizations are regional in scope of service and fund raising, their ultimate goal is judged to be national coverage and, for this reason, NIB includes them. NIB does not undertake to report on religious, fraternal, or political organizations, nor single institutions such as colleges. The decision to limit NIB coverage to a segment of the total philanthropic field is a pragmatic decision of NIB's board. There is nothing in the agency's charter or bylaws that precludes coverage of all of the 174,186 organizations that the Internal Revenue Service, as of March 31, 1974, classifies as "public charities." NIB has information on many philanthropic agencies in addition to those it evaluates. However, this information is not assembled in such a way that it can be subjected to NIB staff analysis and is shared with contributor members for general information purposes only.

Because of limitations of staff and resources, the accreditation effort is focused on the approximately 500 national agencies in the following fields: promotion of "The American Way of Life"; national health organizations; national welfare organizations, general and specialized; national aid to education; organizations of and for veterans; national organizations serving youth; race relations and aid to minorities; civic affairs; conservation and ecology; international relations; foreign relief, aid, or rehabilitation.

Cultural organizations are probably the least well covered of the above categories. This is chiefly because most cultural organizations such as ballet companies, symphony orchestras, museums, and opera companies do not conduct "national" fund-raising campaigns and therefore do not come within NIB's present scope of coverage. With the increased attention being given to encouraging wide public support of the arts, NIB has begun to broaden its coverage in this area.

The individual reports to contributor members provide information on the subject agency's purpose, origin, program, leadership (identity of board members and chief staff), finances, and federal tax deductibility status. This information is presented "from the point of view of a prospective contributor." The report concludes with any general comments that might be helpful to the contributor and, where feasible, with a statement that the agency does or does not meet NIB standards. According to current reports, about one half of the 500 organizations in the bureau's active file meet NIB standards. The contributor is encouraged to support these organizations if he is inclined to do so. For an estimated one fourth of the organizations, the reports state that the bureau has reached no conclusion on conformity with the standards. The remaining one fourth are reported as not meeting the standards. The reports state the reasons for this evaluation, but the contributor is not specifically advised to withhold contributions from these organizations.

All of the reports are labeled as confidential. This precaution is essential to protect the bureau from law suits. General distribution of reports containing an adverse opinion could serve as the basis for legal action to stop an allegedly damaging activity. NIB staff receive many threats of such legal action. However, in its 56 years of operation only one libel suit has been brought against NIB, and it was settled out of court. (The case involved a confusion of the identity of individuals and not an inaccurate or incorrect presentation of other information.)

The reports are more widely distributed than one might assume. The interpretation as to who is eligible to receive or see the reports is liberal. NIB encourages this and knows that its reports are distributed more widely than its formal roster of contributor members would indicate. For example, all of the board members of member agencies of a local United Fund can use the reports received by that local fund. The board members of all of the affiliates of contributor members such as the Ford Motor Company are entitled through membership of the parent company to review the reports. And an organization that is reported on favorably by the bureau will give the report wide distribution among its state and local constituents. When a negative report is issued, the subject organization may also share this with its constituents so that they may more effectively handle any unfavorable response.

In the interests of protecting the bureau, the NIB staff declines to give any information to noncontributor members, other than statements that the subject organization either "meets NIB standards," "has not as yet complied with NIB's basic standards," or "NIB's report on the organization is what we call a non-conclusion report. It cannot be summarized over the phone."

The information that forms the basis for the bureau's reports is in most instances obtained from the organizations themselves. When the bureau learns of the existence of an organization – either through the communications media, tax-exemption records of the IRS, registration records of state or local official regulatory bodies, or inquiries from its members – it invites the organization to complete a questionnaire. This form requests general information, description of purpose, program and organization, identity of board and staff members, and a general summary of financial operations and fund-raising methods. To supplement this information, the organization is asked to provide a statement from its auditor and a copy of the latest audit, a copy of the U.S. Treasury tax-deductibility ruling, a copy of articles of incorporation and bylaws, a detailed budget, current fund-raising brochures and mass appeal letters, and a description of the last fiscal year's program. The questionnaire cites this inducement for the cooperation of the organization: "Potential contributors of money or leadership who consult the NIB may respond more quickly when the facts in this questionnaire are made readily available. The filing of information with us also may obviate the necessity of answering similar questions from numerous local communities."

Those organizations that have already supplied information to the bureau receive a checklist at the end of each fiscal year. They are asked to submit for the completed fiscal year an audit report, the dates of and attendance at board and executive committee meetings, and the agency's annual report. Information requested for the current fiscal year includes the board-approved budget, names of the staff director, officers and members of the board and executive committee, salary ranges of executive staff, and copies of current fund-raising materials.

Not all organizations cooperate, of course. Some groups question the right of the bureau to pass judgment on them and refuse to provide NIB with the information it desires. In these instances, the bureau assembles a report using the organization's published annual report, if any, and the records of the Internal Revenue Service and the New York State Department of Welfare's Charities Registration Bureau. Contributor members frequently volunteer information about organizations, in these situations. The bureau notes in these reports that the organization declined to provide the information needed. Presumably, this might discourage the contributor receiving the report from supporting the organization.

The National Foundation has for many years declined to provide NIB with the information requested. In the opinion of foundation officials, lack of a favorable report from the bureau complicated fund-raising efforts but was not sufficiently troublesome to cause them to compromise their basic conviction that NIB had neither the right or competence to intervene in the dialogue between the foundation and its potential contributors. Several years ago another national fund-raising group supporting a program closely associated with international affairs activities of the U.S. government declined to provide NIB with all of the information NIB believed essential for its evaluatory process. A high Washington official intervened on behalf of the fund-raising group and insisted that for "national security" reasons NIB modify its rigid insistence on total compliance by the group. NIB claims it did not yield to this pressure.

Most organizations, however, apparently regard the NIB's activity as useful to them – or are resigned to it – and routinely provide the information requested.

Beyond the presumably useful function of helping contributors to make informed decisions, NIB's principal value in the voluntary, philanthropic sector is the impact of its standard-setting and standard-maintenance function. The bureau is unique in this area in that it sets out to accredit voluntary groups regardless of whether these groups have expressed the need for such standard-setting. NIB staff can cite many instances where, in the bureau's opinion, organizations have improved their performance as a result of an NIB report which found the organization below par or "substandard," a term frequently used in the bureau's reports. Because of legal constraints mentioned earlier, the bureau does not resort to general publicity intended to disgrace or discredit an organization so as to enforce compliance with its standards. Nor is such an approach believed desirable.

The practical incentive for an organization to meet NIB standards is avoidance of the possible adverse effect on its financial support that an unfavorable NIB report might have. Thus, the organizations must decide for themselves whether NIB's standards should be complied with. The contributor members give at least tacit endorsement to NIB's standards and standard maintenance through their continued membership in NIB and the use they make of NIB reports. The bureau's files are filled with testaments to the value of its standard-setting and standard maintenance, more often from contributors and the communications media than from those organizations that have benefited by the bureau's attention.

The bureau's standards are those that "it believes all philanthropic organizations soliciting contributions from the general public should meet." The Contributors Information Bureau had pioneered the formulation of such standards for New York City voluntary agencies, and these were adapted by NIB for national and international groups. The current standards are essentially the same as those adopted 56 years ago. This is not to imply that they are out-of-date but rather that NIB believes they have withstood the test of time.

Every annual NIB report contains the following statement:

Compliance with the following standards is considered essential for approval by the bureau:

1. BOARD – An active and responsible governing body, serving without compensation, holding regular meetings, and with effective administrative control.

2. PURPOSE – A legitimate purpose with no avoidable duplication of the work of other sound organizations.

3. PROGRAM – Reasonable efficiency in program management, and reasonable adequacy of resources, both material and personnel.

4. COOPERATION – Evidence of consultation and cooperation with established agencies in the same or related fields.

5. ETHICAL PROMOTION – Ethical methods of publicity, promotion and solicitation of funds.

6. FUND-RAISING PRACTICE – In fund-raising:
   - (a) No payment of commissions for fund raising.
   - (b) No mailing of unordered tickets or merchandise with a request for money in return.
   - (c) No general telephone solicitation of the public.

7. AUDIT – Annual audit, preferably employing the Uniform Accounting Standards and prepared by an independent certified public accountant, showing all

Support/Revenue and Expenditures, in reasonable detail. New organizations should provide an independent certified public accountant's statement that a proper financial system has been installed.

8. BUDGET – Detailed annual budget, translating program plans into financial terms.

The information assembled about each organization is analyzed by the 12-member professional staff on the basis of these eight standards. The criteria used for applying these standards – for example, definitions of "ethical methods of publicity" and "responsible governing body" – are largely unwritten. The staff has made several attempts to supplement the standards with more precise written interpretations, but it was finally realized that the more specific the terminology the greater the possibility that the bureau would get bogged down in niggling disputes on isolated points. It is interesting to note that the bureau has, in its recent annual reports, indicated that "ethical" questions are among the most troublesome in dealing with organizations where "substandard" performance is at issue. Considering that NIB's terms are not more precisely defined, this is hardly surprising.

Present staff resources permit NIB to make an evaluation of and report on each of the 500 organizations within 15 to 18 months after information has been submitted. If the information was somewhat dated when supplied by the organization, this would affect the usefulness of the data the contributor receives.

NIB staff, applying the standards as they have been trained to interpret them, can usually decide whether the subject organization is to be "accredited" or whether the bureau is to issue a non-committal informational report or a negative statement. When, in the staff's opinion, a decision is "questionable," it is submitted to the board for a vote.

The regulatory effect of NIB has to be measured in terms of the extent to which organizations are influenced by its standards and whether those standards are appropriate. As stated earlier, NIB staff can cite many instances where they believe NIB has been effective in promoting and maintaining sound standards that assure the contributor of the best possible use of his contribution and encourage performance by voluntary organizations in a manner that will benefit society. However, no comprehensive and scientific study has been made of the effectiveness of NIB. In the bureau's 50th annual report it is stated that NIB initially "undertook to study in *depth* the impact of certain national organizations on local communities, where the ultimate test of achievement lies. After one or two such in-depth studies [site visits] other national agencies were reluctant to be surveyed in this way, so this program . . . had to be discontinued." (If the Filer Commission were to consider the National Information Bureau as a possible avenue for more extensive self-regulatory activity by the private sector, it would be advisable to attempt a more thorough study of NIB's impact within the limited, though very important, sector of philanthropy that it now covers.)

The executive director of the bureau believes that the bureau's services could be expanded to cover all philanthropic organizations. However, to undertake such a vastly expanded operation it would be essential that there be a network of instantaneous communication so that any prospective contributor using NIB data would have immediate access to the latest NIB information about an agency and its conformity to NIB standards. Obviously, this would be an expensive operation to organize, install, and operate. But if NIB's operation is valuable for some contributors to some causes, should it not, then, be equally valuable to all contributors to all philanthropic causes?

IV

COUNCIL OF BETTER BUSINESS BUREAUS: PHILANTHROPIC ADVISORY DEPARTMENT

The Council of Better Business Bureaus, which was formed on August 1, 1970, with the consolidation of the National Better Business Bureau, Inc., and the Association of Better Business Bureaus International, Inc., has a membership of 139 Better Business Bureaus in the United States and in four foreign countries. The network of Better Business Bureaus goes back more than 60 years to the formation of vigilance committees sponsored by local advertising clubs to eliminate abuses in advertising. In 1973, financial support for the local bureaus came from 125,000 local businessmen who paid a total of $12 million in membership dues. The council had $4.8 million in revenue in 1973, of which approximately $4.5 million was provided by the 450 of the nation's 1,300 largest companies that were enrolled as members.

The purpose of the BBB system is to assure consumer satisfaction in the marketplace through business self-regulation and through the development of a more informed consumer public. As a part of this function a number of local Better Business Bureaus maintain services that provide consumers information about organizations soliciting for charity in the community. Many local Chambers of Commerce also have similar operations for their members, and in some communities the two organizations have consolidated this operation. In some of the communities where solicitations are controlled by local ordinances requiring the issuance of a permit, the administration of the ordinance has been delegated to the local Better Business Bureau.

Because their primary goal is to promote fair advertising and selling practices, the early interest of Better Business Bureaus in charitable solicitations was to assure that the soliciting organization was legitimate and that the facts it presented about itself and its cause were accurate. Because so many of the appeals in communities were by national agencies, the National Better Business Bureau collected information about these agencies and distributed fact sheets to the local bureaus and Chambers of Commerce. When the Council of Better Business Bureaus was formed in 1970, this service was performed by the Solicitations Review Section of the Council, subsequently renamed the Philanthropic Advisory Department.

The Philanthropic Advisory Department has developed a program to provide the public, Better Business Bureaus, Chambers of Commerce, corporations, media, and government at all levels with reports on national and international soliciting organizations. Included in these reports is information about the organization's structure, activities, fund-raising methods, financial statement, and tax status. The department also provides advisory and consulting services to soliciting organizations regarding fund-raising ethics and operations. All of the department's services are provided at no cost to the individuals or organizations requesting information, reports or assistance.

At present, the department has a staff of three professionals who are responsible for developing and maintaining resource files on national and international soliciting organizations. Any organization that appeals to a constituency beyond the limits of a single community is within the purview of the department. There is information on file for 5,000 organizations; more up-to-date extensive information is available on the approximately 500 organizations about which BBB is most frequently queried.

During 1973 the department responded to over 10,000 requests for information on national and international soliciting organizations. In January 1973 the department received 600 telephone and mail inquiries. By December of that year, the number of monthly inquiries had jumped to over 2,500. In one week in 1974, approximately 1,300 public inquiries were received.

The department publishes monthly a solicitations review newsletter, *In-Sight*, which gives information on general developments in the charity solicitations field and items of interest about current solicitation campaigns and soliciting organizations. The department distributes 2,500 copies monthly, without cost to the recipient.

When a soliciting organization first comes to the attention of the department – usually through inquiries from the public or from local bureaus or Chambers of Commerce – a questionnaire is sent to the organization. Approximately 90 percent of the organizations provide some, if not all, of the information requested.

At the time an organization is sent the questionnaire, the department contacts the local Better Business Bureau serving the area where the organization is located and requests their assistance in securing information. If an organization maintains its administrative offices in one city and operates a program in another city, the Better Business Bureaus in both areas are contacted. A communication system has also been established with regulatory bodies.

Not all soliciting organizations provide the requested financial information in sufficient detail. By evaluating the information received from various other sources, CBBB is able to determine the scope of the actual programs and services as well as the amount of funds actually spent on programs compared with funds received from appeals. Program verification is a particular problem area. Appeals for the benefit of American Indian reservations and Appalachian communities are examples. The Bureau of Indian Affairs has been particularly helpful in developing information on several solicitation organizations that are reportedly concerned with Indian affairs.

The problem of dealing with groups that operate overseas is even more difficult. When people see on solicitation material that an organization is "registered with the U.S. Government Advisory Committee on Voluntary Foreign Aid" they frequently assume that the organization has passed some sort of test of reliability and that it is "approved" by the government. One of the department's jobs has been to explain that such registration means that an organization has met certain criteria, but does not necessarily indicate that the organization is "government approved."

Another problem occurs when the soliciting organization is religious or religious-affiliated. Most state and local regulatory agencies have traditionally exempted religious groups from their registration and reporting requirements; and it is only since 1969 that religious organizations have been required to file Information Returns (Form 990) with the Internal Revenue Service. Any church or religious group that enters the marketplace or solicits charitable contributions from the public is considered by the council's philanthropic advisory department to fall within its reporting responsibilities. (The department never comments on the religion itself.)

The Better Business Bureau group has in the past encouraged self-regulation primarily by providing facts to potential contributors. To the extent that these facts are perceived to have influenced local licensing bodies in the issuance of solicitation permits or have had a noticeable effect on contributor response, soliciting organizations are motivated to seek a favorable report. The traditional public perception of the goals of the Better Business Bureau has probably resulted in the bureau's having more of a direct impact on contributors than on the soliciting organizations. The volume of mail received by the department from the general public attests to the public's need for help and the widespread assumption that the Better Business Bureau is the place to find it.

Standards for Charitable Solicitations, adopted in 1974 by the council, will be used by the department in future reports on soliciting organizations and by all of the local soliciting groups. (See Appendix A.) The department's intention is "to encourage public support of reputable philanthropic endeavors and to advance high standards of ethical conduct among all soliciting organizations." This objective is consistent with the Better Business Bureau's traditional responsibility for promoting the establishment of standards of ethical conduct in many areas.

In publishing the standards, the bureau stressed that "these basic standards relating to the structure, finances, fund-raising methods, and the advertising and informational materials . . . [of soliciting organizations] . . . are not intended to restrict charitable solicitations but are issued in the belief that both the general public and soliciting organizations will benefit by full and accurate disclosure of all information which potential donors may need and reasonably wish to consider."

The first part of the standards delineates those areas which the department believes are most important for consideration in determining the relative effectiveness and efficiency of an organization. These relate to the organization's purposes, structure, finances, and fund-raising methods. The second part is concerned with the accuracy and completeness of a soliciting organization's advertising and informational material.

Adherence to these standards by all soliciting organizations is the department's goal. It is much too soon to know what effect this effort to encourage self-regulation might have. The Better Business Bureau system has well-established channels of communication through local bureaus and the cooperating Chambers of Commerce. Contributors are likely to be influenced by an opinion offered by a Better Business Bureau; and soliciting organizations may be sufficiently impressed by this potential influence on their appeals to make an effort to adhere to the standards. The department must now undertake the task of evaluating, against its new standards, all of the organizations on which it provides information to the public and to the local bureaus.

The Council of Better Business Bureaus may well prove to be a most effective force for standards maintenance in the private sector of philanthropy. Only after several years and a considerably expanded commitment of council funds can the impact of this endeavor be assessed.

V

UNITED WAY OF AMERICA: COMMITTEE ON NATIONAL AGENCY SUPPORT

If the opportunity to significantly influence a voluntary agency's source of financial support also presents an opportunity for regulating that agency through imposition and maintenance of standards, then the experience of the nation's approximately 1,500 federated fund-raising organizations in health, welfare, and recreation might be expected to provide major guidelines for the Filer Commission in its consideration of regulation of philanthropy, especially self-regulation by the private sector.

The federated fund-raising agencies are members of the United Way of America (UWA), which prior to 1970 was United Community Funds and Councils of America, Inc., organized in 1918 by the then-existing community chests and community welfare councils as a service organization for their mutual benefit.

In 1973 the United Way of America raised $965 million through its local and state affiliates for allocation and distribution to approximately 36,000 national, state, or local voluntary organizations in the fields of health, welfare, and recreation. Voluntary philanthropic organizations in higher education and the arts are not as yet significantly or directly affected by the United Way movement. Voluntary hospitals, some major voluntary health agencies, and some widely supported organizations that rely principally on nationwide direct-mail solicitations are also relatively untouched by the potential regulatory effect of United Way since they elect not to obtain any of their financial support through United Ways' federated fund raising. In many communities, of course, there are variations on the federated or combined fund-raising concept that do include these other organizations, such as combined health drives, united hospital funds, and community drives for orchestras and museums.

The United Way movement must be viewed as one of the most likely devices for self-regulation in private philanthropy, even though many of its beneficiary organizations depend on the United Way for as little as 25 percent of their total income. It is this 25 percent, however, that the organization must be assured of to generate the remaining 75 percent from other sources.

In addition to the "clout" of providing essential seed money to some of the best established and most readily supported public philanthropies, the United Way movement has enlisted the interest, support and commitment of a substantial and influential segment of contributors, especially community leadership that is drawn from representatives of national corporations and organized labor.

How and with what intent, then, does the United Way movement engage in regulatory activities that assure that the giver's tax-exempt contribution is properly used and that philanthropic organizations merit the support of tax-exempt dollars? A simple answer to this question is that United Way organizations – local and national – are pragmatic in their approach, that they make value judgments in terms of priorities for sharing in the always-limited supply of money that must be allocated among the voluntary organizations for which the funds have been raised.

It is not the objective of the United Way movement at the national level to regulate or police its beneficiaries for some general goal related to maximum effective use of the tax-exempt dollar or similar national philanthropic policy considerations. The United Way premise is that there are more valid demands for these United Way tax-exempt dollars than there are such dollars, so value judgments within the movement are made in terms of priority for the United Way support that is available. Those organizations that end up at the top of the priority list receive financial support to varying degrees, depending on local policy and practice. Those that are at the bottom of the list receive less, or nothing.

This is not to say that the United Way movement is not concerned with overall quality of performance of philanthropic organizations. Leadership in the movement at both the national and community level is acutely aware and responsive to the responsibilities that go hand-in-hand with raising and spending the public's contributed funds. Quality performance and public accountability are keystones in United Way administration; the creation of a favorable climate for public support of philanthropy is a continuing goal. But the decentralization of fund raising and decision making, together with the aforementioned imbalance between available funds and deserving recipients, has not contributed to the development of a nationally applicable regulatory system administered against a set of national standards. In addition, there has been no comprehensive or definitive study of the effect of non-receipt of United Way support on agency performance or survival at the community level. Those agencies that have this support regard it as vital to their existence. Whether the agencies denied this support have been forced out of existence or have been stimulated to make whatever changes are necessary to obtain support can only be conjectured. It would seem that because the allocation of United Way dollars is in most communities known to be a process heavily affected by influential forces aligned with the various participating agencies, the regulatory effect of non-support would be less than some might hope. An organization, rather than attempting to improve or change itself, would more likely seek a reversal of the United Way's decision to withhold support, using community influences similar to those enjoyed by the "favored" organizations.

Within the general limits described above, the UWA has established several operations that represent self-regulation within the substantial segment of private philanthropy that it comprises.

To assist local United Way organizations in deciding what support they will give to national agencies – organizations that operate programs with national goals and/or seek financial support nationwide – United Way of America administers the Committee on National Agency Support (CONAS). Reference was made in Chapter II to the interest of the United Community Funds and Councils of America (UWA's predecessor) in the establishment in 1959 of the Ad Hoc Committee on Voluntary Health and Welfare Agencies, its subsequent endorsement of that committee's recommendation for establishment of a national commission on voluntary health and welfare agencies, and its active promotion and support of uniform public financial reporting and accounting standards for voluntary agencies. In the 1940s, UCFCA also participated in the Gunn-Platt study, which, if fully implemented, might have had a regulatory effect on voluntary health agencies.

United Way of America has developed and promulgated minimum guidelines for the performance of local United Way organizations and the much broader and more comprehensive Standards of Excellence for Local United Way Organizations. Both the minimum guidelines and the *Standards* are not requirements imposed on members of the national United Way of America. Rather, these documents contain some suggested standard-setting functions for local United Way organizations to apply to the community services they choose to support. This standard-setting activity of local United Way organizations is discussed later in this chapter.

Committee on National Agency Support (CONAS)

CONAS was established in 1972 by the board of governors of United Way of America as a successor organization to the National Budget and Consultation Committee. The objective of CONAS is "to provide information and judgment, developed at the national level, as an aid to . . . [United Way's] . . . members in their allocations decisions with regard to selected national agencies." It is identified by United Way as an "experiment" and "a link between what existed in the past by way of a national agency review process and whatever new direction the process may take in the future."

CONAS is a subcommittee of UWA's National Planning and Allocations Task Group. The committee has six members, drawn from areas throughout the country.

National agencies (with or without local affiliates) that desire to be considered for local United Way support are invited annually to participate in the CONAS review process. Initially, CONAS was to provide information, "along with some judgments," to local United Ways to help them make decisions affecting those national agencies that sought direct funding from local United Ways and for which there might not be information available locally. In 1974 it was decided to include, if requested, those national agencies that receive United Way funding through their local affiliates.

In 1974, 55 national agencies were invited to participate in the review process. For the 1974 campaign, CONAS reviewed and made recommendations on 15 of the 19 agencies that accepted the invitation. (Four of the respondents did not proceed with the review.) CONAS recommended that 13 be considered for local United Way support. It was carefully specified that CONAS endorsement of the national agency should not be construed as endorsement of any of the agency's local affiliates. The two national agencies that were not recommended for local United Way support were rejected not because they did not merit support but because, in CONAS' opinion, this support should more appropriately come from sources other than United Way. One of these organizations apparently regards the CONAS recommendation as a serious threat to its future and has protested vigorously. As a result, CONAS' decision is being "studied" and, meanwhile, it has been suggested that local United Ways "consider" continued support of the organization.

The extremely limited coverage of national organizations by CONAS (15 out of 55 invited organizations in 1974) means, of course, that it is not at present a major force in regulatory and standard-setting activities for national voluntary agencies. This is in part because CONAS is intentionally a low-key operation and it is in part a reflection of the limited impact of CONAS' much more ambitious predecessor organization, the National Budget and Consultation Committee. Most major national voluntary health and welfare organizations had not observed that participation in the NBCC process was crucial to significant support from local United Funds; and, therefore, they were not persuaded that CONAS, a much more modest operation, would be worth the investment of time and effort.

After its first year of operation CONAS evaluated the process together with a group of national organizations and local United Ways. The issue of greatest concern to the national agencies was the question "of how CONAS, either this year or in the future, would back its positive recommendations with financial support. . . ." This question goes to the heart of voluntary standard-setting and regulatory effectiveness. The local United Ways responded that the "CONAS report was of at least some assistance to the community; the process should be maintained at its present strength."

Participating agencies submit extensive written information which is reviewed and subsequently explored in interviews with volunteer and professional staff representatives of the participating organizations. For the purposes of review and evaluation, CONAS has formulated the following criteria, labeled "Guidelines for CONAS Assessment of National Voluntary Human Service Agencies for United Way Support":

1. **Voluntary Human Service Organization**

Is the organization non-profit and tax exempt? Is the governing body of the organization composed solely of non-paid volunteers? Does the governing body exercise effective control over the organization? Are the organization's goals, objectives and programs within the human service field?

2. **Organization Goals and Objectives**

Are the overall goals of the organization meaningful and legitimate? Do these goals and objectives duplicate those of other existing organizations? Are the objectives of the organization realistic?

3. **Organization Programs**

Are the programs provided directed toward meeting the expressed goals and objectives of the organization? Are these programs provided with a reasonable degree of efficiency and with an adequate amount of resources? Is there a realistic expectation that these programs will achieve some measure of success? Are these programs coordinated with similar or like programs of other organizations?

4. **Appropriateness of Programs for United Way Support**

Should the financial support of the programs provided by the organization be the responsibility, in whole or in part, of the voluntary sector? If they should be, to what extent should these programs be the responsibility of United Ways?

5. **National Scope of the Organization**

Is the organization national in character and in service?

6. **Organization Programs Provided in Local Communities**

Does the organization provide service in local communities across the United States?

7. **Ethical Promotional and Fund-Raising Practices**

Are the publicity and promotional activities of the organization based on the actual programs and operations of the organization? Does the organization only use ethical and appropriate fund-raising procedures?

8. Non-Discrimination

Does the organization adhere to a policy of non-discrimination with respect to persons served by the organization, persons employed by the organization, and persons serving on the organization's governing board? Does the organization have an affirmative action program to ensure equal employment opportunity?

9. Periodic Reporting to the General Public

Does the organization prepare and publish a periodic report for public distribution? Does this periodic report contain a full description of the organization's goals, objectives and programs? Does the report contain the appropriate financial statements, prepared in accordance with *The Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations?* Are these appropriately prepared financial statements certified by an independent certified public accountant?

10. Organization Administration and Management

Is the organization reasonably managed and administered? Are there clear lines of authority between the organization's Board of Directors and the staff? Are the personnel practices of the organization appropriate? Are program service and supporting service – including fund raising – costs reasonable? Are appropriate fiscal controls maintained, including a yearly audit by an independent certified public accountant? Does the organization have a detailed annual budget that is approved at the start of the year by the Board of Directors? Is prior Board approval necessary before significant changes are made in the budget? Is the organization effective in assessing itself and its programs?

National Budget and Consultation Committee (NBCC)

The National Budget and Consultation Committee, which preceded CONAS and which ceased operations in late 1971, is included in this report because its history has significant implications for self-regulatory activities in the private sector. Its objectives, its extensive volunteer participation, and its coverage were more ambitious than CONAS.

As with CONAS, NBCC was primarily concerned with local financial support of national agencies. Its potential impact on this support constituted the basis on which it might affect these national agencies. NBCC was started in 1942 as the National Budget Committee by Community Chests and Councils of America (subsequently United Community Funds and Councils of America and now United Way of America) to review the requests of war-related national agencies. It became the budget arm of the National War Fund; where, in addition to examining the budgets of the participating national agencies, it worked out the distributions of available funds among them. The National War Fund set up a National Quota Committee to develop fair-share campaign quotas for the states.

After World War II, the need for a national agency review process continued. It was apparent that local community chests could not act knowledgeably on the many national appeals reaching their communities. Moreover, national agencies needed a means of communicating their goals and programs and of obtaining adequate financial support from local communities.

NBCC was co-sponsored by UCFCA and the National Social Welfare Assembly. UCFCA administered and financed the programs, and the assembly staffed a Quota and Support Committee which included representatives of the participating national agencies. Scores of volunteers drawn from community agencies and local United Funds served on the NBCC review panels. They advised the participating national agencies on appropriate budgeting procedures in terms of probable local financial support, prepared fair-share quota data, based on community giving ability and giving experience, for use by the local fund-allocating groups, approved support plans tailored to the agencies' established method of financing and sources of support, provided special consultation services, and distributed to about 1,500 United Funds and community chests an annual report of findings based upon the budget conferences with the agencies.

The knowledge and experience of the volunteers, together with the skills of the staff, provided the basis for recommendations regarding the suitability and extent of local support for a national agency. In 1961 NBCC began publishing a manual for use in evaluating organizations. The 1964 edition included standards that had evolved from the process over the preceding 15 years. (See Appendix B.)

These standards could have had an effect on performance of voluntary agencies to the extent that NBCC could use them with local fund-allocating bodies or encourage their adoption and use by the national agencies for which the NBCC review process was intended. But, for reasons described below, the standards were not widely adopted and thus had limited impact. (As described in the next chapter, the National Health Council formulated membership standards for its constituency based on the NBCC standards. The Health Council used the standards not only because of their intrinsic worth but also because it was anticipated that they would be widely adopted by voluntary welfare agencies.)

Many major national agencies never participated in the NBCC review process. Considerable time was required to prepare for the process, and not all agency boards and staff were convinced that the results would justify this investment of time. The NBCC quota system, which provided guidelines to local communities for computing the amount they should allocate to the national agencies, was followed by some communities but ignored by many others.

Many of the non-participating national voluntary agencies were among the largest and most highly regarded. Not only did these agencies continue to receive local United Fund support without the imprimatur of NBCC review and approval, but they did not appear to feel any need for the budgeting and consultation services that NBCC offered. Consequently, NBCC's regulatory or standard-setting potential was quite limited.

NBCC never issued a negative recommendation concerning a participating agency. If there were serious reservations about recommending local support, no report was issued. This fact probably came to be widely understood among potential participants and further limited any possible threat of non-participation in NBCC. Furthermore, UCFCA, as NBCC's principal sponsor, never mounted a sustained effort to persuade local United Funds to adhere to NBCC's recommendations. UCFCA's influence was the only likely source for exerting influence on local decisions, thus constituting a force for self-regulation. NBCC remained a very limited tool for control of local financial support to national agencies. The presence on UCFCA's national board of important representatives of non-participating agencies in the NBCC process may have tempered enthusiasm for an aggressive NBCC.

In 1971 the United Way of America decided that it would no longer support the National Budget and Consultation Committee. A joint committee of the United Way and the National Assembly for Social Policy and Development decided to undertake instead the establishment of "an entirely new independent structure" to be known as the National Agency Review Board.

National Agency Review Board (NARB)

The National Agency Review Board was to be an independent, 501(c)(3) organization with a yearly budget of approximately $200,000, half of which was to come from United Way of America and half from corporations and foundations. All national health and social welfare agencies seeking support "from United Ways, corporations and others among the NARB constituency" would be reviewed "whether or not they sought review by the NARB."

The organization was incorporated on June 22, 1972, in New York under the name of National Contributors Advisory Service. In the 1974 CONAS report, the following statement appears: "Months of work. . .revealed that NARB, as conceived by its organizing committee, was not feasible from either program or financing standpoints." A review of the plans for NARB reveals no practical mechanism for providing the basic incentive for agencies to participate "voluntarily." What was needed was a method of assuring agencies that participation in the review process and approval by NARB could be expected to result in their achieving the local financial support and voluntary participation essential to them.

Presumably, since NARB was to receive financial support from a variety of sources, in addition to United Way, the corporations and foundations involved would exert influence on national agencies to participate and on local United Ways to be guided by NARB recommendations. A significant self-regulatory mechanism would then be in place if it formulated and applied standards. "Accreditation" was cited as one of NARB's aims.

NARB was "to provide the nation with an instrumentality that ensures effective use of resources to meet human needs through national voluntary agencies and programs." The board was to review the programs and budgets of national health and welfare agencies and report its findings to voluntary funding groups such as local United Ways, corporations, labor organizations, and foundations. The ultimate goal of this process was to serve local communities, national agencies, and users of services by ensuring that identified health and welfare needs are effectively and efficiently met.

As envisioned, NARB's operations would have produced the following:

1. A periodically issued social report on the state of the nation's health and welfare as an important basis for NARB decisions.

2. Review and evaluation of the programs of voluntary agencies in the field of human services—both those agencies that voluntarily participate in such reviews and evaluations and those agencies that decline to participate. In the latter case, NARB would note the fact of non-participation and include in its reports such information as might be publicly available, together with such evaluations as would be justified by the available information. There would be review and evaluation not only of the national agencies which directly seek financial support from voluntary funding groups, but those which receive support from their affiliates' dues and/or from individual membership fees or dues. The reviews would be conducted primarily from the standpoint of effective use of resources in actually meeting identified local and national needs. Only secondarily would NARB conduct its reviews from the standpoint of fiscal responsibility and accountability. In conducting its reviews and evaluations of national agencies, NARB would additionally take into consideration the extent to which there was effective fulfillment of the agencies' programs through their respective local affiliates.

3. Stimulation in new ways of meeting new needs at the national level, by such means as

   a) providing a channel of communication between donor groups and national agencies regarding newly discovered needs which existing national agencies might be willing and competent to meet,

b) acting as a clearing house of information on innovative programs and suggesting them to donors seeking "new things" to support.

4. Reports on national agencies to voluntary funding groups which would include
   a) current facts on the agency's program and budget,
   b) NARB's appraisal of the program's priority and its effectiveness,
   c) specific recommendations as to the agency's budget and support plan.

The reviews and evaluations were to be conducted by volunteers who were "not gainfully employed in the human services field." Moreover, conflict of interest was to be avoided by not assigning to review panels volunteers who were board members of the national agency or local affiliate under review.

The NARB proposal did not get far enough to determine whether financing would be forthcoming. Specific standard-setting for participating agencies was not begun. The organizing committee and United Way were unable to recruit the key leadership for the new organization and decided that without this basic ingredient all of the other components could not be assembled and made to function effectively. It is interesting to note that this is the same reason that contributed to the failure of the proposal for a national commission on voluntary health and welfare organizations described in Chapter II.

Standard-Setting by Local United Way Organizations

Previous sections of this chapter have described various efforts of United Way of America to assist local United Ways in deciding which national agencies they will support, and to what degree. As self-regulatory mechanisms, these efforts have been severely limited because local United Ways are not required to accept the recommendations and have been only slightly influenced by the considerations that went into the reports prepared for their use by the national review groups.

Much of the reason for this is that there are more requests for support from agencies than there are available funds. Thus self-regulation, as practiced by most local United Ways, is mainly the development and administration of a set of priority plans and policies for choosing among the needs of various community organizations. The factors that go into the setting of priorities in each community are closely related to the local scene and do not add up to a set of standards that can be used nationally.

Nevertheless, it is obvious that because of its substantial control of the pursestrings, a local fund-raising group could have some self-regulatory effect if it formulated standards and applied them for the purpose of strengthening and improving voluntary organizations. In most communities the realities are that the fund-raising organization is largely controlled by influential members of major recipient organizations and that a so-called priority plan has limited appeal as a method of distributing limited funds.

This probably explains why United Way has not formulated and promoted standards for nationwide use by local United Ways in judging the organizations for which they raise funds. The local fund-raising and allocating process is only incidentally a self-regulatory device.

In guiding local United Ways, the national agency has suggested some standards that the local agencies might apply to agencies and services they support. Local United Ways are urged to "have reasonable standards for admitting new programs and organizations to support." It is suggested that they require the agencies and services to "operate entirely on a non-discriminatory basis with respect to age, sex, race, religion and national origin"; ensure that only services "which meet a significant need" are supported; "operate within approved budgets"; and "adhere to basic guidelines comparable to those set forth" in United Way's basic guidelines for the local United Ways. Local United Ways are further urged to "strive continuously to upgrade the quality of agency service."

VI

THE NATIONAL HEALTH COUNCIL: MEMBERSHIP STANDARDS PROGRAM FOR VOLUNTARY HEALTH ORGANIZATIONS

The National Health Council is a 54-year-old membership organization of national agencies, organizations, institutions, and corporations having an interest in the improvement of the health of the public. The council is a 501 (c) (3) exempt organization, and among the groups comprising its membership are national voluntary health agencies (these agencies are also classified as 501 (c) (3) organizations).

The 19 national voluntary health agencies that belong to the National Health Council include most of the best known and most widely supported of these organizations in the United States. The 19 organizations comprise 11,000 affiliates at the state and community level, the majority of which are incorporated and are classified as 501 (c) (3) organizations under the IRS Code. In 1973 Americans contributed or bequeathed $374 million to these organizations.

In 1964 the National Health Council developed and adopted membership criteria for its voluntary health agency members. (The council has a different membership standards program for the 50 professional, institutional, governmental, and corporate member organizations that comprise the balance of its total membership. These organizations are not within the scope of this report since they are neither 501 (c) (3) organizations nor significant recipients of private philanthropic funds.) The purpose of having standards for these member organizations was to assure the council's board and its other member agencies that the organizations conformed to what would be considered minimum operational requirements for any voluntary organization having custody of publicly contributed funds. The membership standards also included goals for improved performance. Because the programs of the voluntary health member agencies varied widely, the membership criteria focused on only basic measures of organizational structure and operation. Standards to measure program quality were thought to be too subjective. The council's criteria did require, however, that the member organizations' program operations be under the supervision and direction of appropriately qualified volunteers and staff.

The council adopted these membership standards partly from concern about a major scandal involving a voluntary health agency, the Sister Kenney Foundation (which was not at the time a member of the council). The criticisms of the inefficiencies in the voluntary health movement, including that of the council's own ineffective leadership, contained in the Ad Hoc Committee's report were also an important factor. It was apparent by 1964 that the establishment of the proposed national commission was unlikely and that any contribution that the commission might have made to strengthening the voluntary health movement would have to be left to the existing agencies. Since the National Health Council was by that time deeply engaged in implementing the Ad Hoc Committee's recommendation for uniform financial accounting and reporting, it was also appropriate to do whatever else seemed feasible to respond to the Ad Hoc Committee's concern about the efficiency and effectiveness of voluntary health agencies.

Good standards of performance had always been an objective of the council, but the heightened public awareness of the need for standards for voluntary health agencies as a result of the Ad Hoc Committee's report made the members more receptive to the adoption and imposition of standards by the council.

The standards adopted by the council were based on those approved by the National Budget and Consultation Committee in 1963 and were adapted to the particular circumstances of voluntary health agencies. Every effort was made to adhere to the NBCC's standards in the interests of achieving as much uniformity as possible within the voluntary sector. (The council's present membership standards are essentially the same as those presented in Appendix B for the National Budget and Consultation Committee.) Since the standards represent the result of 10 years' experience, they would be an important and useful reference point for any national standard-setting body that might be established in the future.

Since it was expected that all of the member agencies would not be able to meet all of the standards immediately and that total compliance was perhaps an unrealistic goal, the council required that members and new applicants meet the criteria "to a substantial degree." Certain minimum requirements were regarded as "essential," among which was adoption and implementation of the uniform financial accounting and reporting standards discussed in Chapter II. One of the reasons that the council's voluntary health agency members (unlike some of the major member agencies of the National Social Welfare Assembly) participated promptly in the uniform financial reporting program was because this participation was made an essential requirement for council membership.

Member agencies are required each year to present written reports concerning their conformity with the standards. Reports are reviewed by a council staff member; a board-appointed committee considers the staff report and makes a recommendation to the board for membership in the council for the next year. The member voluntary health agencies undoubtedly find the standards program useful in their efforts to maintain and improve their performance. Especially desirable to these publicly supported groups is the opportunity to improve their credibility, thus increasing public confidence and encouraging public support.

The regulatory effect of the council's membership standards program has been limited for a number of reasons. Widespread public awareness of the program has not been achieved and since it is designed as a recognition program for *good* performance deserving of public support, there has, so far, been no effort to seek out organizations that might be invited as members, be scrutinized, found wanting, and so identified to the contributing public.

During the years the program has been in operation, three national voluntary health agencies have withdrawn from membership for reasons not directly related to the membership standards program. These agencies suffered no perceptible loss of public confidence as a result. (Another agency withdrew for reasons directly related to the membership standards; it renewed its membership several years later because the agency had reconsidered the value of the membership standards program and wished to have its benefits.) It would seem that the ultimate test of an effective regulatory program is that non-conformance and non-participation will have adverse effect on the organization in question. Thus far, the council's standards program has had no such effect. Nevertheless, the program has had positive results for those participating and is well accepted.

In 1966 the council considered creating a separate and independent accreditation operation for voluntary health agencies to supplement its membership program. The council board, at its meeting December 9, 1966, considered the report of the committee that had been appointed to study the proposal:

> The Committee met on three different occasions with representatives of the National Association of Manufacturers, the U.S. Chamber of Commerce, the National Industrial Conference Board, the American Federation of Labor – Conference of Industrial Organizations, and the General Federation of Women's Clubs. With each the need for accreditation of voluntary health agencies was explored . . .
>
> As a result of its conferences and consultations the Committee believed that some form of 'accreditation' – i.e., identification and recognition of voluntary health agencies that meet organizational, program, and fiscal accountability

> standards – is needed and that the National Health Council has responsibility to initiate such a move. The Committee and those interviewed agreed that such a recognition program is needed to underpin confidence in voluntary health agencies and attract and retain individual and organization investment of personal service as well as funds.
>
> . . . the Committee believed the program should be one of recognition and have a positive focus. It should periodically endorse the efforts of those voluntary health agencies which democratically operate according to publicly-known criteria recognized by a majority of the health leadership of the Nation as important for service in the best interest of the public which participates in and provides support for the agencies. To the extent that such a program would be inclusive of all eligible agencies it also would be effective in discouraging support for and participation in organizations that exploit the public.
>
> The Committee, therefore, recommended as a mechanism to provide this 'accreditation,' recognition of voluntary health agencies through their acceptance of the standards of membership in the National Health Council.
>
> In the discussion of the Committee's report, a member pointed out his own opinion that the approach recommended by the Committee was based on confidence in the internal dynamics of voluntarism – self-evaluation being stronger than external sanctions – providing there is a real commitment to the concepts of pluralism and voluntarism.

In giving consideration to a more elaborate and costly independent accreditation process the council was responding to the member's desire for a mechanism that would provide maximum credibility for their self-regulatory efforts. The council board was also cognizant of recommendations made by the National Commission on Community Health Services in its 1966 report, *Health Is A Community Affair:*

> M-3. There should be periodic review of all voluntary health agencies, local, state and national, by outside, objective, and competent groups selected by each agency, to insure that programs are continuously adapted to meet changing conditions and needs.
>
> M-5. The National Health Council should accelerate its efforts to develop and evaluate standards of organization and management and fiscal accountability and program performance for national voluntary agencies and their affiliates, leading toward a program of accreditation of such agencies . . .

By deciding against independent accreditation the council invited questions as to the plausibility and credibility of a membership standards program in an organization totally dependent on the dues of those organizations who would be required to conform to the standards.

The council has been working since 1968 to develop and finance a standards program of greater depth, the Participating Agency Review (PAR) program. Efforts to obtain outside financing for the program as envisioned were unsuccessful, and it has now been launched on a voluntary basis among the member agencies. The first test project was undertaken by the Epilepsy Foundation of America, a council member agency where serious questions of continuing eligibility for council membership existed and which, in addition, was the subject of critical inquiry at the 1973 congressional hearings conducted by Senator Walter Mondale (D-Minn.) on fund-raising costs of charitable organizations serving children.

The PAR program enables a national voluntary health organization to examine in depth all facets of its operation. The major purpose is to assist the agency in a self-examination of its national operation, including its relationship to its affiliates, so that it can clearly identify its own needs, objectives, strengths, and weaknesses. The following additional benefits have been identified:

1. Agencies can be helped to identify administrative, organizational, and operational practices which are effectively utilized in other agencies of a similar nature.

2. Agencies will be helped to achieve optimum levels of performance in all areas of their operation.

3. Public knowledge of the existence of this striving towards excellence can help to attract increased amount of support (funds and personal service) for those agencies identified with the Council and, indirectly, to discourage support of organizations that exploit confidence in voluntarism.

There are two parts to the PAR process: (1) a questionnaire (self-study guide) covering all aspects of voluntary health agency operations, developed by council staff in consultation with representatives of national organizations that have developed evaluation programs for their own affiliates; and (2) a peer-review site visit. Upon completion of the self-study guide and prior to the site visit, the completed forms and accompanying documents are reviewed by a council-appointed team of experienced administrators and specialists in the agency's field of operation. This group of experts, the chairman of which has been mutually agreed upon by the council and by the subject agency, visits the agency's national office. In some cases, an affiliate might be visited also. The team interviews members of the staff and volunteers and observes previously selected situations, such as a board meeting, patient service, or a particular office procedure. At the end of the site visit, the review team discusses its findings, and the chairman prepares a written summary which is submitted to the agency for review and action. The only cost to the agency is the expense incurred by the volunteer peer-review team during the site visit. Every effort is made to enlist experts from the same geographical area as the agency's national office.

The council urges that for maximum benefit to the agency and for minimum disruption of agency activities, a complete self-study should be undertaken by each of its members every three to five years, depending on the individual problems of the organization.

If the council is able to provide the required staff services and to persuade its members to participate regularly in the process, the PAR program should add substantively to the quality of the membership standards program and eventually be a useful component in a program of self-regulation by the private sector. Since membership in the council is voluntary, the regulatory effect of such a program is limited. Obviously, those organizations that cannot—or do not aspire to—meet the standards will not be scrutinized. However, the program does involve a substantial number of important voluntary groups to which large public contributions are made. Furthermore, its credibility as an evaluatory mechanism is considerably strengthened when it is realized that the standards program for voluntary health agencies is only one of the programs conducted by an organization with many other members who are not directly involved in the program but nevertheless are concerned that the council's efforts to ensure the best possible performance of voluntary health agencies be as effective as possible.

VII

NATIONAL ACCREDITATION COUNCIL FOR AGENCIES SERVING THE BLIND AND VISUALLY HANDICAPPED

The National Accreditation Council for Agencies Serving the Blind and Visually Handicapped (NAC) began operations on January 2, 1967. It is a nonprofit corporation chartered by the State of New York to help member agencies in the field to achieve maximum effectiveness and give public recognition to such achievement through accreditation. If NAC achieves its objective, it will mean that agencies serving the blind have accepted voluntary self-regulation and self-imposed quality controls.

NAC is governed by a 28-member board of directors elected for staggered terms by an elected membership of "civic and professional leaders, both blind and sighted." The board includes two voting representatives from each accredited agency. Nonprofit organizations that support the objectives of NAC and that are not subject to accreditation may become non-voting associate members (also known as sponsors). At present, there are 110 voting members and 10 non-voting.

NAC's two major operating bodies are a commission on standards and a commission on accreditation. The commission on standards is responsible for undertaking systematic reviews of existing standards and for developing standards in areas not yet covered. It elicits feedback from the field to measure the usefulness and relevance of the standards in practice. It seeks to ensure that the standards reflect the needs of all blind and visually handicapped persons and that they provide a means of measuring outcomes as well as characteristics of services.

The commission on accreditation is responsible for assessing the extent to which agencies and schools make use of the standards. It maintains a process whereby each applicant organization undertakes a rigorous self-evaluation based on the applicable standards and the organization's stated philosophy and program objectives. The completed study report is validated by a team of qualified evaluators who make a three-day visit to the agency or school. The commission then decides whether or not the agency or school will be accredited.

NAC has a professional staff of six. This staff is supplemented by review teams drawn from a roster of more than 800 men and women selected for their professional, technical, and administrative expertise. In 1973 the agency had expenditures of $266,674. Income, which amounted to $293,128 for that year, comes from dues of accredited agencies and from contributions from individuals, organizations, and foundations. Fees paid by accredited agencies are expected eventually to support the costs of accreditation. Major developmental support has been received and continues to be received from the U.S. Department of Health, Education and Welfare and from the American Foundation for the Blind. Federal funds for the initiation and development of NAC were provided through demonstration grants from the Rehabilitation Services Administration of HEW to "strengthen services for the visually handicapped." It was HEW's understanding that an accrediting agency was to be the specific method for accomplishing this objective. In recent years, the amount of federal funds provided has been substantially reduced, not because of dissatisfaction with NAC but because of shifting priorities within HEW.

In an effort to help blind persons live productive lives, society has made a substantial investment in special services, devices, and other forms of support. A carefully documented and generally accepted estimate is that at least $500 million is spent annually on support, services, and devices for the blind. Federal government expenditures comprise approximately half of this amount. Two thirds of the remainder comes from state and local governments. The balance, approximately $83 million, is obtained from private giving.

Unfortunately, these expenditures often fail to produce the desired results. Many blind people remain dependent and unfulfilled even after receiving what appear to be substantial services. They experience isolation, rejection, discrimination, or underemployment. The efforts of specialized personnel are too often inadequate and ineffective. This is the consensus of both blind and sighted persons who are familiar with the situation nationwide.

Concern about the effectiveness of many of the agencies serving blind people has been expressed by knowledgeable leaders in government and elsewhere. When the federal government provided demonstration grants for the development of the National Accreditation Council, it was aware that it had been providing support (either directly or indirectly through the states) for educational, rehabilitation, sheltered employment, business enterprises, health, and other services but had been unable to monitor accurately the effectiveness of these programs because there was no recognized criteria or method for making such assessments. It was this concern that provided the basis for the demonstration grants to NAC.

Although various attempts had been made to develop a means of assessing the quality of services for blind and visually handicapped Americans, the problem had defied solution for many years. For example, in 1954 the American Association of Workers for the Blind (AAWB) adopted a code of ethics and established an award system for agencies that adhered to the provisions of the code. What the plan lacked was both a system for developing and maintaining meaningful performance criteria and a structural base for evaluating an agency in terms of the code.

The 1961 Ad Hoc Citizens Committee report, discussed in Chapter II, voiced the strong conviction that the public "must have more objective information about agency purposes, program content, administration, physical facilities, board structure and function, personnel, financing and budgeting, and relations with other agencies and the community." Later in 1961 the American Foundation for the Blind (AFB) moved ahead to meet this challenge as it related to agencies serving the blind. AFB established an ad hoc advisory committee on accreditation. This committee made a searching assessment of various ways in which the agencies and services available to the blind and visually handicapped might be helped to become more effective and efficient.

The committee issued its report in April 1963. It recommended the appointment of an independent commission to (1) formulate standards for agency administration and service programs and (2) establish an independent organization to administer a nationwide system of voluntary accreditation based on the standards.

The ad hoc body established to formulate the standards was the Commission on Standards and Accreditation of Services for the Blind (COMSTAC). It consisted of 22 members, including lay leaders and persons from government and voluntary services. The members were drawn from all parts of the country and from diverse fields – education, law, community planning, communication, social work, rehabilitation, business, and labor. Five of the commission members were blind.

With encouragement and support from the AFB, three private philanthropic foundations, and HEW, COMSTAC began its work. The first order of business was to develop standards of performance for the agencies and schools serving blind and visually handicapped persons. This is a group of organizations some of which operate under governmental auspices and are entirely supported by tax funds and some of which are under voluntary auspices and supported by contributions from the general public.

COMSTAC developed and codified standards for both administration and service programs. The standards cover agency function and structure, financial accounting and service reporting, personnel administration and volunteer service, physical facilities, public relations and fund raising, education, library services, orientation and mobility services, rehabilitation centers, sheltered workshops, social services, and vocational services. Standards for the production of reading materials in braille, large type, and recorded form were added later. The standards are intended to set a minimum level of performance for all agencies and, at the same time, to challenge the best of agencies to improve their services.

The original standards were published in 1966 in *The COMSTAC Report: Standards for Strengthened Services*, now a major reference in the field. (The Library of Congress published both braille and recorded editions and continues to make them available through its associated regional libraries.) Some of the standards, especially those concerning management, have been adapted by other groups in related areas of health and welfare. The standards have also been reviewed in several languages and have been used by those seeking to develop similar standards in many countries throughout the world.

The second task of COMSTAC was to propose a plan for a permanent, independent, nonprofit organization to help agencies and schools providing specialized services for the blind to utilize the standards for improvement. What it proposed was the National Accreditation Council.

The extensive and detailed standards used by NAC in its accreditation process are too elaborate for inclusion in this report. The standards are based primarily on existing knowledge and practice. NAC's commission on standards revises the standards in light of new research and experience. To help agencies apply the standards, three self-study and evaluation guides have been developed.

There is only one level of accreditation. Organizations that fully and satisfactorily meet the standards are accredited for five years. Others receive accreditation for shorter periods, during which they must make the changes required to meet fully all standards. For applicants who have too many deficiencies, accreditation is deferred. About 50 percent of the recently accredited organizations have been given less than the full five-year approval. NAC has found that the organizations now seeking accreditation, unlike earlier applicants, are finding it increasingly difficult to meet the standards.

Accreditation costs the applicant $150, plus purchase of evaluation materials and reimbursement of out-of-pocket travel and maintenance expenses of the on-site review team. On approval of accreditation, the agency must pay annual dues to NAC equivalent to 1 percent of its annual operating expenditures. In 1974, the minimum annual dues were $50 and the maximum $630.

NAC is recognized as an approved accrediting body by the U.S. Commissioner of Education. Such recognition is critically important in those cases where federal funds for purchase of services are conditioned by requirements that the services be purchased only from organizations that meet certain standards. The federal agency usually specifies that the accrediting body must be recognized by the Office of Education.

The universe to which the NAC accreditation process could apply is estimated to be 400 agencies and schools, about one third of which are entirely supported by tax funds and not subject to the influence of general public contributions. At present, 55 of the estimated 400 organizations have been accredited. The distribution of these is relatively equal between tax-supported and voluntary organizations. Requests for accreditation appear to have leveled off. In the first nine months of 1974, five agencies and schools had been accredited.

NAC seeks to determine on an ongoing basis whether agencies are making the improvements required to qualify for accreditation and whether, once accredited, they continue to make improvements required to retain this status. In 1972 NAC undertook an analysis of 32 agencies that had completed self-studies by December 31, 1971, covering agency function and structure, personnel administration and volunteer service, and social services. Together, the agencies reported 633 improvements, planned or in progress. About 12 percent of the improvements were eliminated as not relating to a specific standard; the remaining 88 percent were coded for further analysis. Examination of the kinds of improvements reported shows that by far the greatest number *could* have been implemented long before the agency undertook its NAC self-study but that nothing had been done until the accreditation process stimulated the agency to take action.

The annual progress reports of agencies and schools provide evidence of the effectiveness of NAC as an instrument of constructive change. However, only about 12 percent of the agencies and schools for which NAC was created to serve have responded to this opportunity to assure their communities that a needed service is being competently rendered and that public funds – whether contributions or taxes – are being wisely spent.

The reasons for NAC's limited coverage of its field are probably linked to the elaborate and time-consuming accreditation process which, even for the most interested agencies and schools, must carry with it a clearly recognizable benefit in order to justify the investment of time and money. Funding sources such as United Ways do not require voluntary agencies serving the blind to have NAC accreditation. An organization of the blind, the National Federation of the Blind, has vigorously objected to NAC's activities as being "elitist." And, even more important in the opinion of the NAC's executive, the availability of federal funds for rehabilitation services (which most of NAC's potential members provide) is not conditioned, either by regulation or legislation, on meeting nationally accepted standards. Such requirements do exist for the allocation of federal funds to educational and health-related institutions. While HEW was instrumental in establishing NAC and in financing its development, it has not taken part in the all-important job of encouraging widespread application of the standards through the powerful instrument of a federal requirement that privately developed and privately administered standards be met.

VIII

SELF-REGULATION IN PRIVATE PHILANTHROPY OTHER THAN VOLUNTARY HEALTH AND WELFARE ORGANIZATIONS

This chapter is concerned with self-regulatory activities in philanthropic areas other than the voluntary human service organizations focused on in earlier chapters. These are the grant-making foundations (family, community, and corporate) which are exempt from taxation because they exist for philanthropic purposes; voluntary hospitals and related institutions, which have a long history of dependence on public contributions, institutions for higher education and cultural organizations, which are tax exempt if they are nonprofit organizations.

For each of these groups of tax exempt institutions, except the grant-making foundation, encouraging public support is vital. When there is a product aimed at a broad segment of the general public – as with universities and other educational institutions, museums, symphonies, opera companies, and hospitals – the marketplace is a major regulatory factor. Giving or withholding patronage of the service offered is the public's ultimate tool for having an impact on the performance of the tax-exempt organization. If few avail themselves of the organization's service, an effort will be made to improve quality and enhance appeal.

For the grant-making foundations, there is no publicly marketed product, and the regulatory effect of the marketplace – that is, demand for service – cannot be advanced by the foundations as evidence of public validation of their worth. This, of course, has been a problem to foundations, especially when their justification for tax exemption comes under scrutiny by Congress. They have no constituency of loyal contributors, patrons, patients, students, alumni and parents.

All of the above-listed sectors of private philanthropy either are engaged in or have considered self-regulation. Accreditation of the institutions that comprise their constituencies is the usual device. The primary motivation for accreditation is the promotion of standards that will result in better performance. The principal beneficiary of accreditation is intended to be the user of the service – the student, the faculty member, the patient, the various technically qualified employees and the agencies expending tax funds conditioned on specific accreditation of the institution. Accreditation is also the only form of self-regulation that serves as a guide for the philanthropic giver. Except in a few selected situations, contributor services such as the National Information Bureau, Council of Better Business Bureaus, and the Advertising Council do not provide evaluations of individual educational institutions, museums, or hospitals.

No one is quite sure to what extent accredited status is a factor in philanthropic support; but it is the one self-regulatory tool that can be cited as evidence of merit for philanthropic giving and for tax exemption.

Council on Foundations

Since the early 1960s, representatives of foundation associations, individual foundations, and government have consistently agreed not only on the need for performance standards for foundations but generally on what these standards should be. Various committees representing the Council on Foundations, the Foundation Center, and the National Council on Philanthropy have formulated proposed standards and have proposed plans for their application, either through voluntary adoption by individual foundations as a code of practice or through an accreditation process operated by the foundations. In each instance, the reports of these committees have been vigorously debated among foundation leaders. While everyone has favored having standards, there has been no general agreement on the degree of specificity of the standards needed and for what foundations or on how standard-setting is to be accomplished and made meaningful.

The 1969 Tax Reform Act codified some of the standards that had been discussed in the field and through federal tax legislation brought about the first broad application of standards to the category of exempt organizations that it defined as "private foundations." In addition to setting some requirements that were considered unsatisfactory by foundations (including a 4 percent excise tax on net investment income and an immense amount of technical regulatory detail), the Tax Reform Act rules out financial self-dealing by foundation trustees and officers and requires public accounting and a substantial current pay-out to charities.

In the years since enactment of the 1969 Act the subject of self-regulation through adoption and implementation of standards has been pursued intermittently, with proponents arguing that the regulatory effect of the 1969 Act provides only the necessary underpinning for broader standards of performance and with opponents arguing that the 1969 Act provides all the regulation that is needed. (The history of self-regulation in the foundation field is summarized in Richard Fitzgerald's article, "Foundation Standards and Accrediting," in the January 1972 issue of *NonProfit Report.*)

The Council on Foundations, the organization to which many of the most influential foundations belong, has participated in most of the discussions about standards. The council's board has decided that because of the diversity of organizations in the field – ranging from The Ford Foundation to numerous corporate foundations and to relatively small family foundations – it would be almost impossible to formulate suitable accrediting standards that could be practicably applied to a constituency that at present is composed of 28,000 organizations (the number of organizations defined by the Internal Revenue Service as private foundations).

Accordingly, in January 1973, the board of directors of the Council on Foundations issued a policy statement which sets forth "general principles and guidelines" that the board hopes "may be useful both to persons responsible for foundations and others concerned about them." In the opinion of the council, issuance of these principles is perhaps the most that can be done under present circumstances.

1. *Basic Rationale.* The grant-making foundation as an institution is a means whereby nongovernmental initiatives and resources can be committed to the service of the public welfare over time. The foundation is thus an element in the creative pluralism of America and is in partnership with all those engaged in the alleviation of the many human needs felt within our society and the world at large.

Foundations have, of course, no magic keys. But overall, in the many diverse efforts they support to heal and uplift the human condition, and where possible to get to the roots of its persistent ills, the contributions of the foundations to human welfare are enormous. When at their proper tasks, they reflect the humaneness of America at its best, as expressions and instruments of the outgoing concern for one's fellow man which is so deep in our heritage and is still so much a part of the nation's best hope.

2. *Diversity.* Grant-making foundations differ greatly in origin, size, purpose, organization and mode of operation. In this diversity they correspond to the multiplicity of society's bona fide charitable needs, and because of it, satisfactory generalizations about foundations are difficult. Within their general philanthropic mandate, it is fitting that some foundations should be concerned particularly with the search for fresh solutions and innovative lines of development while others center more on the support and strengthening of existing institutions of proven worth; that some should favor progressive social causes and others more conservative ones; that some should focus on local or regional needs while others seek to extend their scope of effective concern to human welfare the world around. In these respects no orthodoxy can properly be prescribed for foundations though partisans of various limited interests keep trying to do so. The one common requirement is an essential public spiritedness. While perhaps an awkward referent in a cynical age, a commitment to the service of others must nevertheless be the basic guiding principle for all who direct or manage foundations.

3. *Governmental Supervision and the Tax Reform Act.* The capacity of foundations to contribute to the public welfare under nongovernmental management is the basic justification of the privileges granted to them by both the Federal government and the states – the most important of which is the tax exemption they enjoy. For the same reason, foundation trustees are allowed broad latitude as to how they perceive the public good and what elements of it they wish especially to address themselves to. . . . Despite the 'overkill' contained in . . . the Tax Reform Act . . . the act's forceful reminders that foundations exist for the public benefit and must be so directed have to be recognized as necessary and for the good. The same applies to state regulations affecting foundations where these have been instituted.

4. *Management.* Once a foundation is established and given tax exemption, neither the donors nor trustees nor staff own it. All such parties may and should have critically important roles to play in how a foundation defines its interests, selects its targets and conducts its activities. The essential requirement is that both trustees and employees recognize their involvement in and responsibility for a public trust in relation to which self-aggrandizement and self-dealing can have no proper place.

The degree to which foundation boards or staffs should be diversified in membership to insure independent views and broad representation of the public presents difficult questions. The differences in size and scope among foundations exclude pat answers. Many foundations are being guided with marked sensitivity and concern by a donor assisted only by several friends or associates serving as fellow trustees. Yet, generally, diversified boards and staffs will tend to insure the sensitivity of foundations to the needs of segments of the society who have too often been denied adequate voice and representation. Persons from minority groups and women, moreover, often have important perceptions to bring to bear on foundation activities. Their inclusion in positions of influence within the foundation field is highly desirable.

Whether a professional staff is required by a foundation depends on the nature of the foundation, its program, and the time and attention which trustees can bring to the work. The most important thing is the quality of the work – including its sensitivity and its realism – not whether it is done by trustees, professional staff or consultants.

5. *Evaluation and Program Review.* No foundation, however large or small, should be complacent about the wisdom and efficacy of its giving program. Each should be constantly concerned to see how it can improve its performance and make limited resources meet as effectively as possible needs that generally far outstrip available funding. Periodic, systematic review and evaluation of program can lead to improved performance by the small, trustee-managed foundation as well as the foundation which employs staff and disburses substantial funds. The use of outside consultants or review panels will often add to the validity and usefulness of the evaluation.

6. *Disclosure.* Out of the public trust vested in foundations grows the need to accept the principle of full disclosure and readiness to share with concerned persons, as well as with public officials, information about objectives and activities. Too often foundations have proved inaccessible and their decision-making processes cloaked in secrecy. Federal and in some cases state legislation now require at least minimal disclosure, but positive steps taken voluntarily to minimize secretiveness can better show the concern of the foundations to serve the public with sensitivity and good faith.

A concern for informing the public of what its objectives and activities are – even when very modest – can also often help a foundation's managers gain useful advice and criticism relating to areas of particular interest to them. It also can forestall inappropriate applicants and the irritation of exaggerated expectations let down.

7. *Cooperation.* More cooperative activity among foundations can be beneficial both to them and to potential recipients of foundation support. Small foundations can often increase their effectiveness by pooling resources to employ expert advice or to hire a staff which none of them could afford alone. Community foundations and the larger private foundations can often assist smaller foundations by sharing information and experience.

It is the policy of the Council on Foundations to encourage and extend such cooperative possibilities within the foundation field. At the same time the Council seeks to serve as a center for useful information and guidance for grant-making foundations of all shapes and sizes.

8. *Operating Relations with Government.* The law rules out partisan political activities and, with limited exceptions provided by Congress in 1969, action to influence legislation. Foundations are not barred from sponsoring the study and discussion of public issues even when such issues are taken up by Congress and other legislative bodies. And foundations are fully entitled to inform members of the Congress, as well as other agencies of government and the general public, of their activities.

Moreover, foundations are entitled under the law to interact with executive agencies at Federal, state and local levels. Not only may they work in partnership with government agencies, they can promote objective evaluation and monitoring of government programs, and can fund competitive programs in fields of interest to both government agencies and private philanthropy.

Of the 28,000 organizations to which these principles might be applied, 715 are currently members of the Council on Foundations. The council's professional staff encourages the membership to operate in accordance with the standards that are embodied in the 1969 Tax Reform Act and in the council's "General Principles" listed above.

These principles are not specific conditions of membership in the council. However, the council staff reviews the Form 990 that members and applicants file annually with the Internal Revenue Service to evaluate the organization's conformity with the principles. Applicant foundations are helped to meet the standards and present members are also helped if review of their Form 990 indicates any trouble in compliance with federal regulatory requirements.

Since the council's membership accounts for less than 3 percent of the total potential membership market (even though this 3 percent administers over 65 percent of all estimated foundation assets in the United States), the regulatory effect of the council's principles is limited. Aside from the council there are no other standard-setting bodies concerned with regulation of private foundations.

Joint Commission on Accreditation of Hospitals

The Joint Commission on Accreditation of Hospitals (JCAH) was incorporated as a nonprofit organization in 1951 to encourage the voluntary attainment of uniformly high standards of institutional care. It was sponsored by four major hospital and medical organizations: American College of Physicians, American College of Surgeons, American Hospital Association, and American Medical Association. Representatives of these organizations comprise the joint commission, which is the governing body of JCAH. A large majority of the commissioners are physicians. The four sponsoring organizations contribute to JCAH's financial support, although the amount provided has decreased in proportion to total costs as the commission's programs have broadened and its income from other sources has expanded. In 1974 the four sponsors provided about 3 percent of financial support. The organization's operating budget for that year was $6,550,000, the bulk of which came from accreditation fees paid by participating hospitals.

A systematic program for hospital accreditation was first implemented in 1918 when the American College of Surgeons (ACS) created its Hospital Standardization Program. The need for such a program arose from the lack of adequate information in hospital medical records for evaluating surgeons for admission to the American College of Surgeons. At that time, the average hospital lacked adequate laboratory, X-ray, and other services for making a proper pre-operative study of surgical patients; hospital medical staffs were not organized, and professional work generally lacked proper supervision. In the interest of the public as well as its own organization, ACS developed the Hospital Standardization Program. The program was inaugurated long before state governments established state licensing laws or regulations to ensure quality control.

Although the first standards were general and represented only the minimum of essential requirements, a considerable number of hospitals voluntarily requested a survey. The number of accredited hospitals grew from 89 during the first year of operation (1918) to 3,920, over half of the hospitals in the United States, in 1951. During that period, the standards were continually revised to keep in step with the increasing complexity and sophistication of hospital organization.

However, the Hospital Standardization Program placed a serious financial burden on the College of Surgeons. In order to reduce this burden and to achieve broader support, the joint commission was created.

JCAH's accreditation programs now include hospitals, long-term care facilities (nursing homes and homes for the aged), psychiatric facilities (public and private psychiatric hospitals, community mental health centers, psychiatric outpatient clinics, children's psychiatric facilities, and partial hospitalization programs), and facilities and agencies providing services to mentally retarded and other developmentally disabled persons. Each accreditation program is developed and operated by a separate council, comprised of nationally recognized medical, health-related, and consumer organizations concerned with the particular aspect of health care covered by the council, under the general direction of the joint commission.

Most of the institutions for which JCAH formulates standards are supported principally by consumers, either directly or indirectly from pre-paid or other insurance programs and from tax funds. Construction costs are provided largely from public (tax) funds. Philanthropy is, however, a significant support source; in 1973 philanthropy provided $1.26 billion of total expenditures for personal health care and $730 million of hospital construction expenditures. In addition, a substantial part of the additional $835 million in philanthropic contributions to health agencies in 1973 was probably spent in support of facilities within the scope of JCAH's accreditation activities. Private philanthropy, therefore, has a sizable stake in this self-regulatory program.

JCAH is currently studying the requirements of an organizational structure that would make available the experience and the capability of the joint commission to voluntary accreditation programs in other segments of the health-related services field. In view of the steadily widening field of new and expanding types of health services and facilities, the possibilities for expansion of JCAH's programs are considerable if such an organizational structure can be formulated.

If numerical measures are a benchmark, standard-setting through a voluntary accreditation process has been successful in the hospital field. At present 73 percent (5,500) of the hospitals in the United States are accredited by JCAH. Only 5 percent (1,500) of the long-term care facilities have sought accreditation, but this is a much more recent program in a field where there are many more and much smaller facilities.

Originally, hospitals were principally motivated to seek accreditation because of the interests and orientation of their professional staffs towards accreditation as a device for attaining and maintaining quality. Since health professionals are the essential ingredient in the functioning of a hospital, there was powerful impetus to participate in a program sponsored by the leading national professional organizations in the field.

The program's success, however, is owed not only to its initiation and subsequent acceptance by the health professions: The courts have frequently recognized JCAH standards; JCAH accreditation is required for eligibility for the federal government's Hill-Burton construction funds; membership in certain professional organizations is contingent upon accreditation; and Blue Cross-Blue Shield plans frequently include accreditation in their requirements. New hospitals also seek this recognition, and it is considered an asset in building-fund drives.

In 1965, with the passage of the Medicare Act (P.L. 89-97), JCAH was cast into an entirely new role as a quasi-public licensing body. Under the provisions of the law, in order to qualify for medical payments the hospital must meet such requirements as the Secretary of Health, Education and Welfare finds necessary, except that such requirements may not be higher than those of JCAH. Any JCAH-accredited hospital with an acceptable utilization review plan is deemed eligible to be reimbursed from federal Medicare funds. The growth of accreditation among hospitals was tremendously accelerated by this provision of the law. The much slower growth of accreditation of long-term facilities can be attributed in large part to the fact that certification for Medicare reimbursement of these organizations was not made contingent on JCAH accreditation. A 1972 amendment to the Social Security Act authorized the HEW Secretary to carry out validation surveys of JCAH-accredited hospitals participating in Medicare, and this is being done by the department through an annual sampling. Thus, the federal government is now formally and regularly monitoring a voluntary accreditation process.

The hospital standards originally developed by JCAH were concerned, understandably, with basic physical equipment, maintenance of records and fundamental operating procedures. Eventually, these basics of hospital administration improved and state licensing laws enforcing minimum standards of health and safety were enacted. Revised standards for hospitals were adopted in 1971; the standards for the other three types of facilities covered by JCAH reflect the same thrust as the new hospital standards. While continuing a concern for physical plant, the emphasis now is on standards that will result in improved staff performance and quality of care. The standards do not directly address the topic of quality of medical care but do include requirements for a patient-care audit by the medical staff. The first edition of the 1974 guidelines issued by HEW for the new Professional Standards Review Organizations state that where such an organization delegates the medical care evaluation study requirements to a hospital, JCAH's medical audit procedures, if used by the hospital, are satisfactory fulfillment of the PSRO requirement.

JCAH accreditation is for a period of two years and is based on a self-study report followed by an on-site visit from a JCAH team. Cost of accreditation is $250 per day while the on-site study is being conducted. For hospitals, this averages three days; for facilities serving the mentally retarded, 15 days may be required because of the case-by-case approach that is used for these agencies and institutions. A review by the institution is required annually in the interim between accreditation studies.

The Joint Commission's standards and operations have been the subject of controversy, especially with respect to hospitals and especially since it became highly visible through its role of potential influence on the spending of major public funds through the Medicare program. The standards have been alleged by some to be too low and their enforcement too lax, due to the provider-dominated nature of the JCAH organization. Consumer groups, especially representatives of minorities and the poor, have claimed that JCAH, a private organization, has contributed to the perpetuation of inferior hospital care. From time to time, Members of Congress have proposed legislation that would, in effect, either replace the JCAH role in the expenditure of federal funds or incorporate its activities into a federal system.

In response, JCAH has claimed that it is accountable to the public through the volunteer trustees who govern the facilities it accredits. It has broadened its standards to include a statement about patient welfare and patients' interests and has established a Consumer Advisory Committee. But the joint commission continues, for the present at least, as a provider-dominated accreditation mechanism because it believes that the providers are better informed about and more consistently interested in the complexities of the standard-setting role. Furthermore, JCAH is an expression of the basic philosophy of self-regulation which assumes that self-interest is not so all-consuming that the vested interests can do nothing for the benefit of the consumer.

There have been no studies to measure the qualitative results of JCAH accreditation in terms of patient care, the improvement of which is the ultimate objective of the program. (The newly initiated federal sampling procedure under Medicare focuses on the effect of standards on hospital processes rather than on outcome in patient care, according to JCAH.) It has to be assumed, however, that the application of standards has been sufficiently beneficial to warrant the time, effort, and expense of implementing the program. This is to say nothing of the public confidence that is generated when it is known that facilities have met the standards of a recognized professional body.

JCAH performs its accreditation function in an area where philanthropic support, though substantial, is small relative to public support. The future of self-regulation for all philanthropic activities directly affecting the public good may be found in JCAH's history and in what happens to this program of private standard-setting over the next few years while national health insurance is formulated, enacted into law, and regulations issued.

Self-Regulation In Higher Education

Despite the steadily increasing support that private philanthropy has given to higher education (estimated to be about $2.25 billion in 1972-73), self-regulation for public accountability of philanthropic funds has not been a subject of primary concern within this field. The national organizations that exist to encourage philanthropic support of colleges, universities, and professional schools such as the Council for Financial Aid to Education, the National Association of Independent Schools, the Independent College Funds of America, and the United Negro College Fund have not developed standards by which donors can evaluate the institutions for which philanthropic support is being solicited. As in the case of the Council on Financial Aid to Education, the giver is urged to "give to the college of your choice." There is an almost tacit assumption that any of the institutions of higher education for which these groups are raising funds merits support.

A probable explanation for the absence of such guidelines is the presence of the marketplace factor mentioned earlier. Colleges and universities attract students and distinguished faculty on the basis of quality of education offered. The size and quality of a student body (in relation to the institution's objectives), successful and satisfied alumni and a respected faculty are tangible benchmarks for the philanthropic giver.

Underlying these considerations is the general awareness in the United States of the existence of the accreditation process in education and the likely assumption of most givers that accreditation of educational institutions is a more substantive self-regulatory process than is actually the case. The purposes of accreditation in higher education as it functions in this country are only incidentally for public accountability of the use of philanthropic funds.

Nongovernmental accreditation has come to be the principal means of maintaining academic excellence in post-secondary education in this country. The nongovernmental agencies are considered by the public as the most reliable determiners of quality in post-secondary education, even though many of the 50 states also have agencies that are responsible for accreditation, approval, or registry of institutions or curricula. In nearly all foreign countries these functions are performed by government ministries.

There are two types of accreditation practiced by nongovernmental agencies in the U.S.:

> *Institutional accreditation* is concerned with the quality of the total institution. The best known example of institutional accreditation is that conducted by the six regional associations of colleges, universities, and schools. Control and responsibility for this type of accreditation rests with associations of accredited institutions located in the six regions of the country. They, in turn, are joined together in the Federation of Regional Accrediting Commissions of Higher Education.
>
> *Specialized accreditation* is concerned with a particular field of study. It is conducted on a national basis in fields such as architecture, dentistry, engineering, medicine, optometry and physical therapy. Control and responsibility for specialized accreditation are varied, but primarily involve professional associations and associations of professional schools.

Accrediting agencies have legitimacy conferred upon them through recognition by the National Commission on Accrediting (now the Council on Post-Secondary Accreditation) and/or the U.S. Commissioner of Education in the Department of Health, Education and Welfare, both of whom annually publish lists of recognized accrediting agencies. The criteria used by the NCA and the Commissioner of Education are virtually identical, though the purposes of recognition are different. The Commissioner of Education has since 1952 been required by law to publish a list of accrediting agencies that in his determination are reliable authorities on the quality of education or training offered by educational institutions or programs. The statutory purpose of his role is directly related to the establishment of eligibility for federal funding.

The National Commission on Accrediting was organized in 1949 by representatives of institutions of higher education to control and coordinate accreditation in higher education. The commission relies on the regional commissions of higher education for institution-wide accreditation and recognizes other agencies to grant specialized accreditation. Its list of accrediting agencies serves primarily as a guide to its member institutions.

As noted earlier in this report, accrediting organizations can and do function without authorization from either the NCA or the U.S. Commissioner of Education. For example, the National Information Bureau, in its program for advising would-be contributors, uses the term "accreditation" for those organizations that meet its standards. Both the National Society of Fund Raisers and the National Association for Hospital Development have launched programs "accrediting" individuals, although both the NCA and Commissioner of Education use the term in reference to institutions or agencies and not to individuals.

In view of the fact that the elaborate system of accreditation in higher education serves as the only self-regulation process for this field of philanthropy, it is interesting to note the following observation made several years ago by an authority on accreditation:

> It is likely that few institutions – colleges, universities, hospitals, or technical-vocational schools – would seek accreditation if there were not indirect inducements and potential tangible rewards for their doing so. Although there are few legal requirements that an institution or program of study must be accredited by a 'voluntary' accrediting agency, nevertheless it is the unusual institution that can afford not to seek accreditation in order to facilitate faculty recruitment, student admissions and transfers, and graduate employment; to attain eligibility for grants; and to maintain status with the public and within the professions.[9]

In recent years accreditation as it has developed in higher education has been the subject of increasing criticism and dissatisfaction within the field. Part of this dissatisfaction has probably resulted from the fact that accreditation is being used for purposes for which it was never designed, such as interlocking arrangements with state licensure authority for professional licensing as lawyers, dentists, physicians, etc. Similarly, the federal agencies that use "voluntary" accreditation as the basis for federal funding have been critical of the lack of public accountability of accreditation in higher education. This latter issue is of relevance to private philanthropy as well.

The National Commission on Accrediting has not effectively addressed the issue of public accountability. Established criteria for recognition of accrediting agencies do not require that governing bodies include public members and that due process be observed in formulating and promulgating standards.

American Association of Museums

The American Association of Museums (AAM), founded in 1906, is the professional organization of museums in the United States. It is governed by an elected council; its policies are carried out by a director and professional staff. Among its other objectives, the association strives to raise museum standards. In 1970 it began a program of museum accreditation.

There are approximately 1,820 art, history, and science museums in the country (including museums with a combination of these subjects), and 1,385 of these are members of the AAM. In 1971-72, the private sector provided $326.7 million for support of these tax-exempt institutions through gifts, membership and admission fees, special fund-raising events, and United Fund organizations. The public sector (federal, state, municipal government) provided the remaining $186.6 million of the total $513.3 million income in 1971-72.[10] An interesting feature of philanthropic support of museums is that it has come primarily from local giving rather than from national foundations and corporations.

The association's accreditation program was financed during its formative period by grants from the Smithsonian Institution. The Rockefeller Brothers Fund sustained the program in its first three years of operation.

The association describes the accreditation program as follows:

> AAM members throughout the country had voiced the concern that many museums functioned without benefit of prescribed professional standards by which their quality and performance could be judged; and there was strong opinion that the museum community as a whole should attempt self-evaluation through some instrument created by AAM . . . to develop public confidency by certifying in some visible manner that a museum meets professional standards. . . Finally, they felt that accreditation would be important to private and governmental agencies as a basis for qualitative judgment in approving requests for contributions, grants and contracts.

Momentum for an accreditation program had come from *America's Museums: The Belmont Report,*[11] a 1968 report of the Federal Council on the Arts and Humanities, which stated that "it is urgent that the American Association of Museums and its member institutions develop and agree upon acceptable criteria and methods of accrediting museums."

A seven-member accreditation commission, appointed by the president of AAM, administers the program which consists of voluntary application (membership in the association is not a requisite for accreditation, nor is accreditation a requisite for association membership), a self-study questionnaire that must be completed within one year after application, and a site visit by a visiting committee if a review of the completed questionnaire has resulted in "interim approval." Accreditation is granted after the accreditation commission reviews the report of the visiting committee. Reaccreditation procedures are now being developed, with five years as the projected interval.

When the program was initiated there was concern that the museum field is so inherently diverse that a single accreditation program would be impractical. There was also concern that accreditation might impose standardization in an area that is characterized by and valued for the individual and unique contribution of each institution.

The AAM accreditation system is based on this fundamental definition of a museum:

> . . . a museum is defined as an organized and permanent nonprofit institution, essentially educational or aesthetic in purpose, with professional staff, which owns and utilizes tangible objects, cares for them, and exhibits them to the public on some regular schedule. The key words used in the definition are further defined as follows:
>
> *Organized*
> . . . duly constituted body with expressed responsibilities.
>
> *Permanent*
> . . . the institution is expected to continue in perpetuity.
>
> *Non-Profit*
> . . . the museum has produced documentary evidence of its tax exempt status under the regulations of the U.S. Internal Revenue Service or the Canadian Department of Internal Revenue.
>
> *Essentially Educational or Aesthetic*
> . . . the museum manifests its expressed responsibilities by knowledgeable utilization of its objects and exhibits for elucidation and enjoyment.
>
> *Professional Staff*
> . . . at least one paid employee, who commands an appropriate body of special knowledge and the ability to reach museological decisions consonant with the experience of his peers, and who has access to and acquaintance with the literature of the field.
>
> Stress is placed on continuity of professional staff, even seasonal employment which is continuous and not automatically terminated at the end of each season. The employee works sufficient hours to meet adequately the current demands of administration, record keeping, and care of collections.
>
> *Collections*
> . . . owns and utilizes tangible objects, things animate and inanimate. The tangible objects have intrinsic value to science, history, art, or culture. The exhibits are evidence of the subject matter of the museum rather than tools for com-

municating what one knows of that subject matter, serving as instruments in carrying out the museum's stated purpose and reflecting that purpose.

Care
. . . the keeping of adequate records pertaining to the provenance, identification, location of the museum's holdings; and the application of current professionally accepted methods to their security and to the minimization of damage and deterioration.

Open to the Public on Some Regular Schedule
. . . regular and predictable hours which constitute more than a token opening, so that access is reasonably convenient to the public. The hours and seasons the museum is open adequately support public demand.

The association believes that its accreditation program is progressing well. By September 1974, there were 310 museums accredited and an additional 270 had requested applications. The rate of growth has been slow but steady. Two states, New York and Florida, have enacted legislation in which state support for museums is conditioned on AAM accreditation.

IX

ISSUES IN SELF-REGULATION FOR CONSIDERATION BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS

General Observations

During this study several persons expressed the opinion that self-regulation by the private sector, including philanthropy, is a myth in the United States – a concept that the private sector believes it practices and behind which it rallies when the threat of governmental intervention is perceived. Others claim that public regulation, as exemplified by federal regulatory agencies and by state licensing bodies, is captured by vested interests in the private sector soon after the public regulatory body is created, if indeed the enabling legislation has not already built in private control of the public function.

Our descriptions of existing self-regulatory mechanisms in private philanthropy do not necessarily confirm such a cynical viewpoint. This report recites the private sector's concern for and sincere interest in self-regulation. At the same time, however, it is apparent that the effectiveness of the described efforts to regulate philanthropy in order to ensure appropriate use of tax-exempt funds has neither been thoroughly studied nor convincingly demonstrated. On the basis of present knowledge and understanding of self-regulation in philanthropy, the observations above cannot be convincingly contradicted.

Certainly, it was the absence of effective self-regulation that contributed to the restrictive regulations imposed on private foundations in the Tax Reform Act of 1969. This report makes it evident, too, that self-regulatory mechanisms have made no startling progress among private foundations since 1969. The recent amendments to the Social Security Act requiring the federal government to "sample" the judgments of the Joint Commission on Accreditation of Hospitals is evidence of concern about the effectiveness of that agency. In the preceding chapter there was discussion of the criticism of accreditation by the private sector in higher education. In addition, it has been pointed out that well-known national public philanthropies flourish despite the fact that they do not meet the standards of the National Information Bureau, do not choose to be identified as meeting the standards of the National Health Council or the National Accreditation Council for Agencies Serving the Blind and Visually Handicapped, and do not participate in the United Way's new evaluating mechanism, the Committee on National Agency Support.

This report has summarized, in considerable detail, the efforts of the private philanthropic sector to establish independent national commissions or boards that might serve a regulatory purpose. Before it died in 1964, the proposal for a National Commission on Voluntary Health and Welfare Agencies had been carefully edited to specify that the proposed commission would not have a regulatory purpose or function. The more recent effort by the United Way of America to set up a National Agency Review Board was deemed "not feasible" because if the proposed agency were successful in its objective, it would inevitably be controversial, and prominent volunteer leadership is not looking for such a role when that leadership engages in activities relating to philanthropy.

Self-regulatory efforts have been operating since the establishment of the Contributor's Information Bureau in New York in 1882. There are two goals: (1) to encourage the best use of philanthropic funds by setting standards for organizations engaged in programs supported by the funds, and (2) to assist the contributor in making an informed and, it is hoped, a wise decision about giving. With the subsequent enactment of tax legislation, another objective was to ensure that the purposes for which the contribution and the recipient organization were exempt from taxation were being pursued.

Some of the so-called self-regulatory organizations are not primarily engaged in philanthropy; but, wishing to encourage support of private philanthropy, these organizations provide their members with an information service that, through the use of standards for evaluation, will, it is hoped, channel philanthropic dollars to the organizations that meet their standards. Others attempt, through the application of standards to soliciting organizations, to improve these organizations' quality of performance and, accordingly, to show that they merit the receipt of philanthropic funds.

The report has presented information about the scope of these various operations in terms of their probable effect on the tax-exempt charitable organizations with which they are concerned. If the accepted universe is the 226,122 organizations classified as tax-exempt under section 501(c) (3) of the IRS Code (as of March 31, 1974), then the combined scope of all the activities described herein far from covers this universe. If the success of regulation is wide numerical coverage, then self-regulation today is not significant. But if selective coverage that includes the most widely supported philanthropies is an important objective, the programs described in this report are most significant.

The method of self-regulation used is either accreditation or a modification of this peculiarly American process for utilizing peer standards and peer judgments. Many of the standards used have been presented in this report. Some sets of standards are general, allowing for wide latitude in judgment. Others are more comprehensive and specific. Only in a few programs is there first-hand observation through site visits to the organizations being evaluated. With a few exceptions, the number of personnel engaged in these programs is minimal. In most cases, there can be no expansion of current program activities without additional resources.

The study revealed no data that scientifically document whether self-regulation has accomplished its goals. Nevertheless, none of the organizations question the usefulness of the service they perform, and the author shares their belief that many contributors like to have other judgments about organizations that they are considering supporting. The files of all of the organizations are filled with individual testimonials about the valuable guidance given, either in selecting charities wisely or in helping a charitable organization perform more effectively through standard setting.

As for the broad question of whether self-regulation has resulted in discriminating support of philanthropic activities and maximum effective use of tax-exempt philanthropic funds, there is no present answer. Most organizations lack the research component to evaluate their activities in these terms. Moreover, there is debate about how to measure the success of any accrediting process. One group argues that success can be measured by applying a set of precise standards to the specific areas for which they are intended and cumulating the results. Another group contends that broader standards designed to measure achievement of the desired output is a more worthwhile, goal-oriented process. Beyond this technical debate, the awakened consumerism of the 1960s and 1970s has exposed the traditional accreditation process to charges of elitism and of being a device for the protection of vested interests.

Even though self-regulation in philanthropy preceded by many years any interest in the subject on the part of legislators, basic regulation by law is now accepted as desirable. All of the standards of the regulating groups begin with requirements of federal tax-exemption and of legal organization for the receipt and handling of money. One of the mechanisms used by the National Health Council and the National Social Welfare Assembly in building acceptance of their public financial reporting standards was to get state and local administrators of charity registration laws to require the use of the standards.

The report has pointed out the federal government's use of private standard-setting bodies in determining the basis for its expenditures in education and health care services. The federal government is now questioning whether some changes are not desirable. It is suggested, for example, that accrediting agencies become more closely related to the public interest and less dominated by those organizations or agencies that have set them up.

From the private sector viewpoint, equating eligibility for federal dollars with conformity to standards of a private standard-setting organization has had marked effect on self-regulation. When Medicare legislation was passed with its references to the standards of the Joint Commission on the Accreditation of Hospitals, "voluntary" participation in that organization's program jumped 25 percent. The National Accreditation Council for Agencies Serving the Blind and Visually Handicapped attributes its very limited numerical coverage of its field primarily to the fact that regulations for federal support to organizations within NAC's universe are not conditioned by a requirement for NAC accreditation. The approval program of the National Council for Homemaker-Home Health Aide Services, designed to improve the operations of community homemaker-home health aide agencies, lagged when federal regulations for Medicaid dropped references to the standards of the council and similar private groups.

Issues for the Commission

What, then, is the significance of this report to the Commission on Private Philanthropy and Public Needs? The report can have usefulness only if, and when, the Commission decides that (1) regulation of private philanthropy is a desirable national policy, and (2) at least part of the regulatory function should be performed by the private sector.

Should the Commission come to the second part of this decision, it will know from this report that there is an extensive, experienced establishment working toward self-regulation of private philanthropy. Even if the Commission decides to recommend that the total regulatory responsibility be placed in the public sector it should utilize the experience and knowledge that has been accumulated by the private sector.

The report confirms that none of the self-regulatory mechanisms are fully effective, and some are only minimally so. *A plan for underpinning the self-regulatory efforts with a minimum, uniform, annual, registration program in every state and a federal program of commitment to support standard-setting activities of the private sector would enhance and strengthen the undoubted values of self-regulation as a principle in our society.* This would encourage the private sector to concentrate on what it can do best—work with its peers on developing and maintaining high standards and wider support of its programs.

The state registration programs should be designed to assure that the registering agency is organized and operating to accomplish its tax-exempt purpose ad that there is full and regular public accountability. With vigorous administration of state legislation, with minimum federal standards and the cooperation of the federal government in promoting further private standard-setting, fraud and quackery could be controlled and the self-regulatory mechanisms of the private sector could exert leadership for improved performance in spending the philanthropic dollar. The development of a uniform, public financial reporting system by the private sector in the past 15 years illustrates what private standard-setting organizations can accomplish with a tangible, valid, and desirable objective.

The Commission must also consider the practical implications of any decision to assign regulatory responsibilities to the private sector. Based on what we now know about self-regulatory activities in philanthropy, the Commission cannot decide that self-regulation could be expected to accomplish whatever may be the Commission's intended objectives for self-regulation. Either the Commission decides that the status quo in self-regulation as described in this report is satisfactory for its purposes, or, before placing more responsibility on self-regulation, *it should plan and promote a thorough assessment of what self-regulation has in fact accomplished and can reasonably be expected to accomplish. A hard unbiased look at the history and current status of accreditation, especially in higher education, would be an essential ingredient of such a study.*

An implementing organization in the private sector may be needed, either temporarily or, perhaps, permanently. The author agrees with Dr. Hamlin, the study director for the Ad Hoc Committee, that the effectiveness of permanent evaluating bodies tends to diminish with time.

If the Commission's deliberations reach this stage, the establishment of a successor national commission, or the reshaping of the present Commission is a possible recommendation. If this is done, the experiences of the Ad Hoc Committee and the United Way of America, described in Chapters II and V, should be helpful in planning the new body. Neither the organizers of the proposed national commission on voluntary health and welfare organizations in 1961 or the United Way of America with its proposed National Agency Review Board in 1972 were able to get these concepts into operation. The so-called Peterson Commission in 1971 stopped short of recommending a new self-regulating mechanism for private foundations.

The scope of the Filer Commission is broader and more ambitious than any of these earlier studies of private philanthropy. If the Commission decides that a new national organization with a standard-setting goal for furthering and strengthening private philanthropy is needed, it must obtain suitable leadership (the fatal deficiency in earlier similar attempts), be assured of financing, and have some reason to expect that the essential, further study of self-regulation will result in convincing, practical proposals that the new organization can use as the basis for its continuing program operations. This is the basic first step that Dr. Hamlin urged in 1961 during deliberations of the Ad Hoc Committee, a step without which, he claimed, the recommendations of most study groups have a "hollow ring."

Appendix A

Better Business Bureau Standards for Charitable Solicitations

Part One

Purposes, Structure, Finances and Fund-Raising Methods

1. General Requirements

a. A soliciting organization shall disclose upon request the ruling of the Internal Revenue Service regarding its tax-exempt status.

b. A soliciting organization shall disclose in all charitable solicitations whether or not the organization is qualified to receive contributions deductible for federal, state and local income tax purposes.

c. Upon request, a soliciting organization shall make available its annual report containing detailed information on its activities, actual accomplishments, and voting trusteeship.

d. A soliciting organization shall be operated in accordance with its stated purposes and applicable federal, state and local laws and regulations including those relating to nondiscriminatory practices.

2. Purposes and Programs

a. Soliciting organizations shall have a written statement of purpose which shall serve as the basis for and be described in all charitable solicitations.

b. Should eligibility to benefit from an organization's program be limited for any reason (e.g. specific facilities, geographical areas, or classes of persons), such limitations shall be clearly and fully disclosed in all charitable solicitations.

3. Structure

a. Soliciting organizations shall have an active and responsible governing body operating under by-laws which ensure an adequate voting trusteeship.

b. Paid staff members shall not constitute a majority in any decisions of the voting trusteeship.

c. Upon request, soliciting organizations shall clearly disclose the responsibilities, organization and decision-making structure, and location of operating facilities of their national, regional and local offices.

4. Finances

a. Soliciting organizations shall obtain and make available to the public upon request an annual external audit from an independent or certified public accountant to be conducted in accordance with the *Audit Guides* (published by the American Institute of Certified Public Accountants), or in accordance with the generally accepted standards of financial accounting and reporting for the organization's particular field.

b. Soliciting organizations shall include in their annual financial report to the public all income and all costs for fund-raising activities including special events. Following each separate, local charitable solicitation, the soliciting organization shall provide upon request a full accounting of gross receipts, total expenses, net income and income accruing to the organization for whose benefit the charitable solicitation was conducted.

c. Soliciting organizations shall report as fund-raising expenses all direct and indirect costs related to activities and materials that are an integral and inseparable part of any charitable solicitation.

d. All costs of joint informational programs shall be reported as fund-raising expenses with the exception, only, of marginal or additional costs directly occasioned by the separate, educational or other informational material or activity.

5. Fund-Raising

a. Soliciting organizations shall provide to the public at the time of an appeal a clear and concise description of the programs and special projects for which contributions are being solicited.

b. Soliciting organizations shall not pay commissions, kick-backs, finders' fees, percentages, bonuses or over-rides for any fund-raising activity, including telephone, door-to-door, direct mail or other method.

c. Soliciting organizations mailing unordered items (e.g., pens, seals, name labels, ties, stamps, etc.) shall clearly disclose that recipients are under no obligation to pay for or return the items received.

d. Any offer for sale of merchandise made in conjunction with a charitable solicitation shall clearly disclose the amount of percentage of money from the sale which will actually go to the organization for whose benefit the appeal is made.

e. Soliciting organizations shall not mail disguised appeals, such as telegrams, invoices, bills and statements of account.

f. Any telephone appeals shall accurately disclose at the outset of the call (1) the name of the soliciting organization, (2) the purpose of the call and (3) how further information can be obtained.

g. A soliciting organization shall provide to all individuals who approach the public for the purpose of charitable solicitation, an identification card or badge containing its name and address and the individual's name.

h. Soliciting organizations shall institute adequate systems of control over canisters or collection boxes, tag days, telethons, walk-a-thons, benefits, raffles, bingo contests, and all other special fund-raising activities as specified in the *Audit Guides* (published by the American Institute of Certified Public Accountants).

i. Soliciting organizations shall not use techniques of intimidation, including threats of public disclosure or economic retaliation, harassment, etc.

j. Soliciting organizations providing goods, admission to fund-raising activities, or other services in return for payment shall clearly disclose the portion of payment which constitutes a charitable contribution for tax purposes.

k. Soliciting organizations shall retain the confidentiality of contributions.

l. Soliciting organizations shall honor the request of any person to have their name removed from the organization's mailing list.

m. Soliciting organizations shall not disclose or use the name of any person, organization or company in any oral or written solicitation without obtaining advance written authority to do so.

n. A soliciting organization shall not solicit funds for the benefit of, or in the name of, another organization unless it has written permission from the benefiting organization to do so. The soliciting organization shall provide full financial reports in accordance with Section 4.b. of these standards.

Part Two

Advertising and Informational Materials

The following standards shall apply to all advertising and informational materials directed to the contributing public by charitable organizations, in whatever form and by whatever means, including, but not limited to, print and broadcast media, direct mail literature, window display signs, counter cards, public notices, canisters, brochures and flyers. They are intended as guidelines to assure that all public communications accurately and factually represent the purposes, needs, programs and services of charitable organizations.

1. Basic Principles

a. The responsibility for truthful and non-deceptive advertising and informational materials rests with the soliciting organization and the entity which prepares and assembles such materials.

b. Advertisements and informational materials shall not be untrue, misleading, deceptive or fraudulent in whole or in part.

c. Advertisements or informational materials may be considered misleading as a whole although every sentence separately considered is literally true. Misrepresentation may result not only from direct statements but by omitting or obscuring material facts.

d. Soliciting organizations shall be prepared to substantiate any statements or claims made before publication and, upon request, present such substantiation promptly to the advertising medium, the Better Business Bureau and the public.

e. Any description or reference to a program or service by a soliciting organization shall be factual and accurate.

2. General Requirements

a. Advertising and informational materials shall not disparage any person or group on grounds of sex, race, color, creed, age, nationality, mental or physical condition or social status.

b. Statistical data shall be based on factual or representative situations.

c. All claims and promises shall accurately reflect existing conditions, situations and circumstances.

d. An asterisk may be used to impart additional information about a word or term which is not in itself inherently deceptive. An asterisk, footnote or other reference symbol should not be used as a means of contradicting or substantially changing the meaning of any advertising statement.

e. Advertising and informational materials shall not state or allude in any way to compliance with or adherence to the provisions of these standards.

3. Disclosure Requirements

a. Soliciting organizations shall disclose the following in all advertising and informational materials (see exception in b. below):

(1) The name of the soliciting organization and the source from which the public may obtain additional information regarding the organization's programs and services.

(2) A statement as to whether or not the organization is qualified to receive contributions deductible for federal, state and local income tax purposes.

(3) A statement of the purpose for which the soliciting organization was established.

(4) A clear statement of any limitations to benefit from the soliciting organization's program.

(5) A clear and concise description of programs and special projects for which contributions are being solicited.

(6) A clear statement disclosing the amount of percentage of money derived from the sale of merchandise which will actually go to the organization for whose benefit the appeal is made.

b. If, due to time and space limitations in advertising (i.e., spot announcements, small print ads), it is impracticable and economically unfeasible to make any disclosure, (except III.A.1. relating to the source for additional information which is required in all cases), the soliciting organization shall in any event file the required disclosures with the medium along with its proposed advertising.

4. Layout and Illustrations

a. The composition and layout of advertising and informational materials shall be such as to minimize the possibility of misunderstanding by the reader.

b. Photographs, films and illustrations of programs, services or recipients of aid shall be accurate and typical representations of the programs, services and recipients of aid of the soliciting organization.

c. If models are used to portray recipients of aid or beneficiaries of programs and services, clear disclosure of that fact shall be made in immediate conjunction with the portrayal.

d. If photographs are used, dates and sources shall be disclosed if failure to do so would be misleading.

5. Testimonials and Endorsements

a. Statements in advertising and informational materials by doctors, dentists, nurses or other professional people shall be presented by members of such professions reciting actual experience, or it shall be made apparent from the presentation itself that the portrayal is dramatized. No such presentation may be placed on television except in the context of a public service announcement approved by the broadcast medium.

b. Persons making testimonials, endorsements, or who are pictured in advertising or informational materials shall be identified as to their relationship with the organization and their actual experience with the organization's programs and services.

c. If an endorser has a direct pecuniary interest in the organization whose program or service is being endorsed, this shall be disclosed in the advertisement or informational materials.

d. Testimonials or endorsements shall be quoted in their entirety, unless failure to do so does not alter the overall meaning and impact of the testimonial or endorsement.

e. Testimonials and endorsements shall be genuine and actually represent the current opinion of the endorser.

f. If the endorser is associated with some well-known and highly regarded institution, the endorsement shall clearly disclose whether the endorser speaks in a personal capacity or on behalf of such institution.

g. Advertising and informational materials shall not use an endorsement or approval by indefinitely large or vague groups, such as "the doctors of America."

These standards do not apply to appeals conducted by churches, fraternal, civic, professional or trade groups where the appeal is confined and directed exclusively to the organization's voting membership; is an invitation to such membership; or is a request for support without any charitable purpose associated with the appeal.

Appendix B

National Budget and Consultation Committee Standards for National Voluntary Health, Welfare, and Recreation Agencies

1. Basic Organizational Requirements

The agency must be incorporated, have adopted bylaws, and be organized and operated in pursuance thereof. It must—

a. be established and operate as a non-profit, tax-exempt corporation, gifts to which are deductible by the donor for federal income tax purposes;

b. operate in the health, welfare, and recreation field.

2. Voting Membership

The voting membership exercising basic legal control of the agency should be defined in the corporate and related papers. This membership should be representative of the main interests in the agency's field of work. It should—

a. elect the board so that it reflects the will of the agency's membership;

b. possess the power of amendment to constitution and bylaws;

c. have an annual meeting, with adequate notice of and information about matters to be acted upon.

3. Governing Arrangements

The governing arrangements should include at least—

a. a board, adequate in number to represent the main interests in the agency's field of work, meeting regularly, establishing policy, providing supervision of operations and finances, and serving without compensation (except for reimbursement of expenditures for fulfilling the responsibilities of board membership), subject to the following conditions:

(1) A specified plan for turnover or other arrangements which provide for new members is essential;

(2) There should be a minimum aggregate of four meetings annually of the board or the executive committee, including at least two meetings of the board, with average attendance of at least 50% of their respective memberships;

(3) In measuring the degree to which the board fulfills its functions, the nature of its deliberations as well as the activity of members in operating committees and in providing leadership, interpretation, guidance, and support in other ways should be considered.

b. an executive who may act for the board during intervals between its meetings;

c. additional committees to assure the performance of the main functions of the agency and to provide a sound basis for board decisions;

d. provision for the election of officers, their terms, tenure, and the filling of vacancies.

4. Personnel Policies and Staff

The agency should—

a. have a written statement of personnel policies, job descriptions, and provisions for staff evaluation, formally approved by the board and made available to the staff;

b. employ an executive director and professional staff with qualifications appropriate to the agency's field of operations.

Agency policies should be established by the board and administered by the staff. The executive director should not be a member of the board but, with other staff personnel as needed, should attend board meetings and participate in the deliberations of the board and formulation of policy.

5. Need, Goals, Program

The agency should operate in a defined area of need, should specify its goals, and conduct its programs to meet that need. Periodically it should reassess such need, goals, and program. Conformity to this standard should be measured by such criteria as—

a. evidence of need;

b. definition of the segment of need served by the agency;

c. resources for a substantial program in the area of defined need;

d. maintenance of accurate service records;

e. understandings with other agencies in its field to prevent wasteful duplication;

f. projection of long-term and short-term program goals for specified periods, and a method of board review of achievements reached at the end of such periods;

g. ability and willingness to change or modify goals and program in response to need and public interest, and in cooperation with appropriate planning agencies.

6. Budget

The agency should—

a. operate on an annual budget under defined procedures of budget preparation with board examination and formal adoption;

b. control expenditures by such approved budget, with significant departures permitted only by board or executive committee authorization.

7. Support Plan

The agency's financial planning should annually—

a. assess and specify financial expectations as to source, amount, and equitable distribution of support;

b. use a support plan based on the preceding, which, in the light of previous experience and current conditions, sets forth a reasonably dependable method for obtaining the income budget for the period under consideration.

8. Nondiscrimination

An agency which exists to serve people generally should not determine the availability of its services or the membership of its board or staff by considerations of race, religion, or national origin.

9. Cooperation with Tax-Supported and With Other Voluntary Agencies

The agency should maintain relations with tax-supported and other voluntary agencies in or related to its field of services. This would include—

a. registering research and demonstration projects with pertinent information-exchange centers and making appropriate use of resulting information;

b. clarifying respective roles and relationships of voluntary and tax-supported agencies working in the same field;

c. participating in national planning bodies;

d. recognizing the obligation not to make substantial alterations of major program functions without consulting other affected agencies.

10. National-Local Relationships

The national agency should establish such relations with local communities as the nature of its work requires. Thus—

a. All agencies (whether or not they have local united or community-centered programs) should—

. . . initiate local fund raising or services only after consulting community planning and fund-raising bodies and existing related agencies as to need and arrangements;

. . . maintain relationships with these local planning bodies, and with state and local public bodies having planning responsibility, in cooperation with its local units where these exist, or directly if there is no organized community unit;

. . . maintain channels by which local views and needs on program planning, fund raising, and other matters of concern may be transmitted to the national agency;

. . . provide for the maximum degree of local autonomy consistent with national-local charter or affiliation agreements.

b. Agencies with local units should in addition maintain—

. . . affiliation or charter agreements which specify the relationship between the national and the local, outlining the structure, services, and financial operation of the local unit together with the responsibilities and accountability of the national office thereto (such agreement should be available for review by appropriate planning bodies);

. . . adequate arrangements for seeing that the local units fulfill the charter or affiliation requirements and, depending on the type of agency, for the provision of such services as program leadership, standard setting, counseling, and evaluation of local operations.

11. Education Program

The agency's education program should have valid content which is beneficial to significant audiences. This program and its cost should be differentiated from promotion publicity for fund-raising purposes and its cost.

12. Fund Raising and Promotion Publicity

The agency's promotion publicity should adhere to ethical standards, such as respect for clientele and factual accuracy regarding needs served, character of services offered, the volume provided, and other accomplishments. The agency should follow accepted practices of fund raising, and it should comply with all the applicable legislative requirements.

It should not mail unordered tickets or merchandise with a request for money in return, raise funds from the general public by paid telephone solicitors, or enter into arrangements to raise funds on a commission basis. It should make honest disclosure of fund-raising costs to contributors and the general public.

Fund-raising costs, including those of related promotion publicity, necessarily vary from agency to agency, but in general should not exceed 25% of the funds raised per year in the first five years of operation or 15% of such funds per year thereafter. In judging whether an agency's fund-raising costs are correctly stated and reasonable, factors to be taken into consideration should include the extent of public understanding of the agency's work, factual justification of costs, and the use of sound accounting practices.

13. Financial Management and Accounting

Generally accepted standards of financial management including the bonding of personnel handling finances should be adhered to.

The agency should have its accounts audited annually by independent certified public accountants, whose examination should be made in accordance with generally accepted auditing standards. The audit report should include—

a. financial statements showing all of the agency's income, disbursements, assets, and liabilities, together with changes in endowment and other funds, reserves, and surplus during the period, all in sufficient detail to be in accord with sound accounting practices (it is emphasized that all items in the foregoing categories, which are under the agency's ownership or control, must be included in the financial statement);

b. an auditor's certificate in the conventional form developed by the American Institute of Certified Public Accountants.

The agency should participate in efforts to develop systems of accounting—in cooperation with representatives of contributors, other agencies and the general public—which will work toward comparability of items from agency to agency. When a system of uniform local reporting has been developed* which is acceptable to the accounting profession, agencies, significant contributor groups, and contributor reporting services, the agency should adhere to it.

14. Public Reporting

The agency should make annual program and financial reports to its membership and the general public. The financial report may be in summary form but must be consistent with the audit report. The agency should respond to requests for detailed information on any aspect of its operations or program from any responsible source.

15. Evaluation

The agency should have an orderly plan for periodic evaluation, whether by staff and board arrangements, outside consultants, or a combination of both. While it is to be expected that evaluation would be a continuing function of administration, formal evaluation should be undertaken periodically by the board to review the program in light of current needs and in terms of the agency's stated purposes, specified goals, and relations with other agencies in its field, especially tax-supported agencies. The agency should cooperate with independent evaluating bodies in an effort to provide an objective report for the general public.

---

*When the National Health Council and the National Social Welfare Assembly published *Standards* (See Chapter II), this NBCC standard was changed to recommend adoption of the published *Standards*.

Appendix C

List of Organizations Described in Report

The Advertising Council
825 Third Avenue
New York, New York 10022

American Association of Fund-Raising Counsel, Inc.
500 Fifth Avenue
New York, New York 10036

American Association of Museums
2233 Wisconsin Avenue
Washington, D.C. 20007

Council of Better Business Bureaus
(Philanthropic Advisory Department)
1150 17th Street, N.W.
Washington, D.C. 20036

Council on Foundations
888 7th Avenue
New York, New York 10019

Joint Commission on Accreditation of Hospitals
875 North Michigan Avenue
Chicago, Illinois 60611

National Accreditation Council for Agencies Serving the Blind and Visually Handicapped
79 Madison Avenue
New York, New York 10016

National Association for Hospital Development
Box 561
Tucson, Arizona 85103

The National Council on Philanthropy
680 Fifth Avenue
New York, New York 10019

The National Health Council
1740 Broadway
New York, New York 10019

National Information Bureau
419 Park Avenue South
New York, New York 10017

National Society of Fund Raisers, Inc.
130 East 40th Street
New York, New York 10016

United Way of America
(Committee on National Agency Support)
801 North Fairfax Street
Alexandria, Virginia 22314

Footnotes

1. These official regulatory activities are the subject of other papers prepared for the Filer Commission.

2. Ewald B. Nyquist, "The Meaning and Purpose of Accreditation" (paper delivered at meeting of the board of directors, National Accreditation Council for Agencies Serving the Blind and Visually Handicapped, New York City, November 9, 1967).

3. See Appendix C for a list of organizations described in this report.

4. Ad Hoc Committee, An Exploratory Study of Voluntary Health and Welfare Agencies (New York, N.Y.: Schoolmasters' Press, 1961).

5. Selskar M. Gunn and Philip A. Platt, *Voluntary Health Agencies, An Interpretive Study* (Ronald Press Company, 1945).

6. In the introduction to its report, the Ad Hoc Committee does acknowledge that "a major reason for this study was the heated debate and increasing competition among independent and federated fund-raising groups."

7. In a recent discussion, Dr. Hamlin commented that he still believes in the efficacy of ongoing study and observed that, for voluntary health agencies at least, study by a national group seems to happen periodically, as with the Gunn-Platt study of 1941-1945, the Ad Hoc Committee's study in 1959-1961, and part of the work of the Filer Commission.

8. As a result of this decision by the board of the National Health Council, one of its important member organizations, the National Foundation, resigned. The president of the National Foundation at the time, Basil O'Connor, was critical of the Ad Hoc Committee, its report, and especially the recommendation for a commission.

9. William K. Selden, "Research in Accreditation of Health Educational Programs," Part One: Working Papers (Washington, D.C.: Commission on Study of Accreditation of Selected Health Educational Programs, 1971).

10. Museums USA (Washington, D.C.: Government Printing Office, 1974).

11. American Association of Museums, *America's Museums: The Belmont Report* (Washington, D.C., 1968).

PRESERVING THE PRIVATE VOLUNTARY SECTOR: A PROPOSAL FOR A PUBLIC ADVISORY COMMISSION ON PHILANTHROPY

Adam Yarmolinsky[†] and Marion R. Fremont-Smith[*]

The positive benefits to society from a vital and effective private voluntary sector warrant continuing efforts to strengthen and improve its performance. There is, however, no single body, public or private, with the continuing responsibility for assuring that the conditions under which philanthropy can grow and improve are nurtured within the private sector itself, nor that the unique role of philanthropy and the contributions it makes to our society are adequately considered in the course of government decision making. Neither government nor the private sector itself are taking adequate steps to protect this essential resource, much less to strengthen it against future crises.

The Internal Revenue Service does review the operation of philanthropic organizations to assure that they meet the conditions for tax exemption; congressional committees do from time to time examine certain aspects of philanthropic activity; and the attorneys general of a few states do attempt to enforce fiduciary standards in the operations of charitable organizations, although these efforts are limited and fragmented. But regulation by the Internal Revenue Service and, in a few states, by an attorney general is not sufficient. It provides no means for analysis of regulatory measures, existing and proposed, to determine whether they are too strict or too lenient; it cannot produce the data on philanthropy – who is acting and to meet what needs – necessary to identify emerging needs and determine whether existing ones are being adequately met. There is no one to speak for the private voluntary sector as a whole when Congress is considering changes in tax laws that will affect it, nor to identify and point out the impact of other government actions that would affect it.

In short, although private philanthropy, like government, is dedicated to meeting public needs, it has no advocate within government nor before the public. What is needed, therefore, is a voice for the private voluntary sector, with the information to speak intelligently about how the sector operates and with the access to reach into the council chambers as well as the hearing rooms of government.

We do not believe this can be done within the private sector itself. The private voluntary sector is neither organized nor supported to perform adequately this increasingly important role. Its very independence and diversity operate against finding a common entity which would receive sufficient support from all of the components of philanthropy. It could not obtain the vital information that is needed from all elements of the voluntary sector, nor could it speak with sufficient authority to Congress, the Treasury or any other federal or state body.

What is needed now is an independent public body, operating without regulatory powers, but employing the tools of information gathering, analysis and public discussion, which can stimulate and encourage private efforts to improve the performance of the private voluntary sector and can act as its spokesman within the government. We are aware that the Peterson Commission proposed a permanent Advisory Board on Philanthropic Policy that, although federally mandated, included only private individuals. We believe, however, that any such body should include representatives of both the public and private sectors so that differences could be thrashed out before they are aired in a congressional or executive hearing room.

[†] Ralph Waldo Emerson University Professor, University of Massachusetts.

[*] Choate, Hall & Stewart, Boston, Massachusetts.

This memorandum offers a proposal for the creation of an independent public agency, the Advisory Commission on the Voluntary Sector. The primary focus of the proposed commission would be on the organization, the functioning, and the results of private philanthropy, as well as the relationships between donors and donees. It would have no enforcement powers (except to require submission of reports), but would achieve its objectives through studies, dialogue, and dissemination of its findings and recommendations. It would engage in a continuous process of interpreting the philanthropic sector to the general public and interpreting changing public attitudes to the private sector. Specific proposals are offered below for the focus of the proposed commission's work, the kinds of activities it might undertake, the way its governing board might be selected, how it might be staffed and funded, and what special problems it might encounter. A draft statute to establish the commission is appended.

ADVISORY COMMISSION ON THE VOLUNTARY SECTOR: A PROPOSAL

Functions

In pursuing its concerns, the proposed commission would have six principal functions: as an information source, as a clearinghouse, as a provider of technical assistance, as an architect of guidelines and criteria, as a source of encouragement for greater private effort, as a watchdog for the public interest.

As an *information source*, the commission would collect, organize, analyze and disseminate data bearing on the activities of private donors and donees, as well as public contributions to philanthropic organizations.

As a *clearinghouse*, the commission would provide for regular exchanges of ideas of information among philanthropic organizations and regulatory bodies.

As a provider of *technical assitance*, the commission would offer help to donor and donee organizations, as well as respond to requests from the Treasury and the Internal Revenue Service.

As an architect of *guidelines and criteria*, the commission would articulate non-binding standards for those aspects of the management and operation of private voluntary organizations that they all share. Clearly the commission would not attempt to tell colleges what their educational policy should be or hospitals what health care standards they should observe. Rather it would be concerned with fund raising, management of assets, and accountability.

As a *source of encouragement* for greater private effort, the commission would seek ways to foster increased voluntary contributions of resources and energies to the private philanthropic sector on a continuing basis and would act as a public interest spokesman within the government.

As a *watchdog* for the public interest, the commission would review the work of regulatory agencies and their impact on philanthropic organizations and donors. It would analyze proposals for new legislation and regulations with special attention to Treasury Regulations and Revenue Procedures. It would also generate regulatory and legislative proposals on its own. Within its own area, the commission's activities would be analogous to the recently expanded functions of the General Accounting Office.

Concerns

The commission's focus would be on three major concerns: The need for private philanthropic activity and the extent to which those needs are being met, the processes through which philanthropic activity takes place, and the ways in which private giving and the recipients of private giving are regulated.

Needs, as indicated above, encompass both the role of private giving in meeting the needs of private philanthropic organizations and the role of those organizations in meeting public needs. Given the accelerating pace of social change, this concern would emphasize the role of voluntary activity in fostering innovations, in both private and public spheres.

Examples of possible commission undertakings in this area of concern include:

- An annual report on the size and shape of the private philanthropic sector in the economy, and the sources of its support, with an analysis of trends. Such a report would be somewhat analogous to the annual report of the Council on Economic Advisers, and could be quite widely disseminated.

- A study of the implications of the changing relative roles of private and public funding in the support of voluntary hospitals, in the light of impending changes in the health care system.

- A study of the funding of public interest law firms with a view to identifying alternative rationales for and ranges of private support.

- A cooperative study with the Overseas Development Council of the changing roles of private relief agencies, the Agency for International Development, and international public agencies in administering emergency relief programs.

- A study of the giving habits of families and individuals in the lower half of the income distribution. Such a study would be conducted so that once a base line had been established, trends could be determined.

- A study of the probable impact of alternative minimum tax proposals on gifts to various classes of tax-exempt organizations. Such a study would draw on, but also supplement, data collected by the Internal Revenue Service, and might be a basis for testimony before the appropriate congressional committees.

Processes encompass the ways in which donor and donee organizations are established and governed, how they provide access to those seeking funds or services, how they make disclosure of their operations to the general public, and how they obtain funds, whether for their own purposes or for distribution, whether from mass solicitation or limited individual giving, whether from private or public sources.

Examples of possible commission undertakings in this area of concern include:

- A study of solicitation practices of large charities, including analysis of patterns of internal organization and relations with outside professionals. Such a study might be updated periodically.

- A study of ways to increase voluntary service by persons desirous of making philanthropic contributions.

- A study of giving practices of large business corporations, with special reference to the apparent tendency to abandon corporation foundations.

- A study of the process for winding up organizations that have outlived their usefulness.

- A study of the problems of museums and performing arts groups in finding the proper balance between increasing outreach and assessing costs to users.

Regulation encompasses the ways in which donor and donee organizations are regulated by federal, state, and local government, as well as the ways in which these organizations and groups of organizations attempt to regulate themselves. It also includes reconciling the effects of independently generated and administered state and federal requirements.

Examples of possible commission undertakings in this area of concern include:

- A survey of the impact on philanthropic organizations of grant conditions imposed by the National Endowments of the Arts and Humanities and the National Institutes of Health, including the effect of matching requirements.

- A study of the need for further government action to modify obsolete or impractical purposes of long-established organizations and of whether the federal government or the states should have primary jurisdiction over such modifications.

- A study of the impact of equal-opportunity regulations on philanthropic organizations.

- Development of a Model Code of Conduct for trustees and directors of philanthropic organizations.

- An analysis of the effectiveness of state laws and local ordinances regulating the public solicitation of funds, including the question of whether federal regulation of some kind may be desirable.

The combination of these three major concerns with *needs, procedures,* and *regulation* will raise questions about the standards of *accountability* that are being applied, explicitly or implicitly, to the philanthropic sector, and the proposed commission should be able to contribute to the public dialogue in that area as well.

To try to encompass the entire subject matter of philanthropic activity is beyond the capacity of any oversight commission, since this activity involves complex questions in fields such as education, science, the arts, and welfare, each of which has its own area of expertise. The concerns envisioned for the proposed commission are common to all fields of philanthropic activity, and by limiting its focus to these concerns, the commission's task should be manageable and should avoid improper intervention in specialized substantive activities.

Methods

In carrying out its functions and pursuing its concerns, the proposed commission would employ six methods: organizing available data, obtaining supplementary data, conducting special studies, disseminating materials, offering consultative services, and serving as convenor agency.

A good deal of the factual material needed for the commission's work consists of already *available data* collected by the Internal Revenue Service or other agencies, and which would have to be made readily available to the commission.

The commission would also need to have the authority to gather *supplementary data* as needed from donee and donor organizations and state and local regulatory bodies.

The commission would need to conduct a number of *special studies,* some of them on a continuing basis, both in-house and by contracting with other entities and individual researchers. These would include studies of the extent and seriousness of abuses, including abuses of solicitation.

The commission would need to organize an extensive program of *dissemination* both for materials that it produced itself and for other material produced outside the commission that it found useful. One of the kinds of data that the commission might disseminate would be a directory or directories which would be more informative than those currently issued by the Internal Revenue Service. It might at some time be able to establish a central registry of the data. Where specific areas of abuse are found, this information would be transmitted to appropriate state and federal authorities in addition to the general public.

The commission would serve as a *convenor agency* for gatherings of donor and donee groups and regulatory agencies and for interchanges among these groups. The commission would also convene a biennial National Conference on the Private Philanthropic Sector.

Organization

As a public body dealing with independent private constituencies, the proposed commission should be an independent federal government agency, organized outside the confines of any of the cabinet departments.

A commission form with a chief executive officer selected by the commission seems more appropriate than a single-headed agency for dealing with policy issues in the private sector. Further, it seems preferable for the commission members to serve on a basis that permits them to retain their principal career commitments.

There are a number of ways in which membership could be allocated. A general pattern is suggested by the Advisory Commission on Intergovernmental Relations, which includes representation from federal, state, and local government and from the executive and legislative branches.

In order to assure adequate expression for all the major points of view involved in shaping public policy in this area, commission membership might be structured along the following lines: four members from the executive branch of federal government — the Secretary of the Treasury, the Commissioner of Internal Revenue, the Secretary of Health, Education and Welfare and the Director of the Office of Management and Budget; four members from the legislative branch — two Senators and two Representatives, selected by the legislative leadership on a bipartisan basis; four members of state and local government — two governors, a representative of the National Association of Attorneys General, and a representative of the United States Conference of Majors; twelve private citizens — three who would bring the viewpoint of donors to the commission and nine who would bring the viewpoint of philanthropic organizations and of the beneficiaries of their services. This last group would include persons affiliated with a wide variety of organizations in all of the major areas of philanthropic activity, such as education, health, social welfare, the arts and humanities, civic and public affairs, and religion. These individuals from private life would be nominated by the President with the advice and consent of the Senate, also on a bipartisan basis, for fixed and staggered terms. The full-time chief executive of the commission, after his selection by the commission, would serve as an ex officio member thereof in order to enhance the stature of his position.

The commission in turn would name an advisory council of up to 100 members, representing all segments of the philanthropic sector and again including beneficiaries. The council would play a major role in filling vacancies in the commission from private life, and in the biennial conference described above.

In preparing the legislation to create the commission, its proponents should seek to make legislative history emphasizing the need for the broadest range of representation both on the commission and its advisory council, with special emphasis on those groups that have had limited access to sources of support.

Staffing

The proposed commission would require only a very small central staff, and indeed its operations should be more effective and efficient if it depended primarily on outside consultants for studies and reports, maintaining only enough staff to select, supervise, and evaluate the work it contracts or makes grants for. A staff of approximately ten professionals should be sufficient, and there should be a serious commitment to resist the bureaucratic imperative of expansion, perhaps adopting the informal rule of the ACIR that there should never be as many employees as there are commissioners.

Funding

The proposed commission should be funded from federal government appropriations, preferably under a multi-year authorization in order to enhance its independence. A $3,000,000 to $4,000,000 annual budget seems a reasonable approximation for austere but effective operation, assuming a core budget of approximately $1,000,000, and $2,000,000 to $3,000,000 in project and contract operations. Some part of the amount might be matched by imposing a modest registration fee from those organizations filing reports with the commission to be treated as U.S. Treasury miscellaneous receipts. If 200,000 organizations qualifying under section 501(c)(3) were to pay a $10 fee, the total amount would provide the equivalent of two thirds of the suggested budget. Religious bodies might be exempted from the fee requirement, in order to avoid a possible constitutional question.

Special Problems

Although the most troublesome problems of the proposed commission probably cannot be anticipated, there are a number of problems that must be expected and can be discussed at least briefly in advance. They include duplication of effort, lack of authority, establishment and maintenance of stature and objectivity, and avoidance of undue restraints on innovation.

If the commission proposal is pursued seriously, the counter-argument will undoubtedly be advanced that it would only be duplicating information already collected by other agencies, public and private, including particularly the Tax-Exempt Organizations Division of the Internal Revenue Service. The short answer to this argument is that information on philanthropy is still woefully inadequate, as the work of the Filer Commission has demonstrated. We do not have an adequate breakdown of giving by substantive fields, and we know very little about the giving patterns of the multitude of small givers. We know very little about the economics of operating philanthropic organizations, and the effect their tax-exempt status has on their decisions. Furthermore, what information we do have is not organized in the most usable ways.

But more specifically, in order to be really useful, the collection of information must be related to substantive purposes, and the substantive purposes of the commission would be different from the purposes of the Internal Revenue Service or any existing private organization. The commission's special concerns would be reflected in the way it collected information, how it organized that information, and how it used and disseminated the information. It would rely heavily on raw data collected by other agencies, particularly the Internal Revenue Service, in addition to its own direct data collection, but the value of work would be in the way it handled the raw data – and also in the requirements it generated for additional data. Further, although it would be placing additional burdens on the organizations from which it received reports, its special concerns would make it particularly sensitive to the problems of multiple reporting requirements.

It is an essential element of the commission proposal that it should not have any regulatory authority other than to compel the filing of reports. Otherwise the pluralism and diversity that are at the core of the rationale for private philanthropy may be threatened. But without regulatory authority, how are the commission's recommendations to be carried out? The force of publicity may be a significant factor. In the past, philanthropy has tended almost to overreact to criticism. It is, however, subject to criticism from many sources, and the criticisms are often mutually inconsistent. Private organizations are urged to be bold but not to be controversial, foundations are urged to maintain spending levels but not to invade corpus, to state their program limitations but not to exclude worthy objects of benevolence outside their program guidelines. How will the views of the commission get appropriate attention?

The answer may have to be found in the resolution of the next problem: establishing and maintaining the stature and objectivity of the commission. Its initial stature will depend both on the way it is set up and on the caliber of the initial appointments. They will have to be the kind of people who already have the respect of opinion leaders generally throughout the country. It will not be enough for these appointees to be well regarded by the large givers and by the trustees of the major foundations, because commission reports will have to resonate with public opinion, in order to be effective. Good advice will not be taken just because it is good advice.

The commission will have to be extraordinarily solicitous also of its reputation for objectivity, since it could be so easily dismissed either as a creature of philanthropy itself, or as an instrument of populist forces desiring to cut back the role of philanthropy. There are no formulas to resolve this problem, beyond diligence and good judgment, and assuming that able people have been selected to do the work of the organization.

Once the commission has established its capabilities and its bona fides, it should be listened to, and its recommendations fully considered by donors, donees, the rest of the government and the general public. But at that point the opposite danger may develop, that its recommendations gain such general acceptance that they become serious restrictions on the substantive judgment of donors and donees, and even dull the famous cutting edge that philanthropy and voluntarism is thought to have in public policy development. Here again, the principal safeguard is the good judgment of the commission and its staff. If they do try to assume a coordinating role, there will be a backlash, either from philanthropy or, more likely, from the groups or classes of grantees that are adversely affected. It seems reasonable to suppose, however, that, as the Council of Economic Advisors has not been able to achieve a monopoly on opinion about the economy, and the National Science Foundation has not been able to achieve a monopoly on opinion about fundamental scientific research, so the commission would find a good deal of healthy competition in opinions about the proper conduct of philanthropy.

As pointed out above, no commission can deal with all of the substantive problems and policies of the various kinds of philanthropic organizations. Any body that attempted to do so would destroy itself in the process. Nor is a bureaucratic enterprise envisioned, particularly where the only regulatory function is to compel production of information. If the public representatives on the commission or members of the staff attempted such an expansion of its activities, they would be restrained by the private members. In turn, the vigilance of the private members would be maintained through the process of nomination by the 100-member advisory council.

What the commission could do, in sum, would be to provide a generally respected voice, speaking out so as to be heard throughout the country in the public and private sectors, on the role of philanthropy, both the giving and the doing. This sector is going to need a good deal more, and more effective, support, both public and private, if it is to continue to contribute significantly, as it has been doing, to the quality of life in the world today.

Appendix

AN ACT

To establish an Advisory Commission on the Voluntary Sector

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

ADVISORY COMMISSION ON THE VOLUNTARY SECTOR

SEC. 1. There is hereby established a permanent non-partisan commission to be known as the Advisory Commission on the Voluntary Sector, hereinafter referred to as the "Commission".

DECLARATION OF PURPOSE

SEC. 2. American society has long been distinguished by the existence of an active and independent private voluntary sector complementing the work of government in serving public needs and, at the same time, providing qualities of pluralism and innovation that are essential to the general welfare. The independence of this sector requires that a significant portion of its support be derived from private giving, which presents special problems affecting the integrity of the tax laws and the effectiveness of the charitable deductions thereunder. To assure the continuing independence and significance of this vital component of American life, it is essential, therefore, that an appropriate agency be established to encourage, strengthen and improve the private voluntary sector and the flow of private giving.

It is intended that the Commission, in the performance of its duties, will –

(1) collect, organize, analyze and disseminate data bearing on the private voluntary sector;

(2) provide technical assistance to the private voluntary sector and to governmental agencies with regulatory responsibilities in this sector.

(3) recommend means of fostering increased contributions of resources and energies to the private voluntary sector;

(4) recommend methods for improving standards and accountability of organizations in the private voluntary sector; and

(5) review the work of regulatory agencies and their impact on the private voluntary sector.

DEFINITIONS

SEC. 3. For purposes of this Act,

(a) the term "private voluntary organization" shall mean an organization described in section 501(c)(3) of the Internal Revenue Code of 1954, as amended.

(b) the term "private giving" shall mean contributions by private individuals and nongovernmental organizations including business corporations to private voluntary organizations.

(c) the term "private voluntary sector" shall mean the totality of activities of private voluntary organizations and private giving.

MEMBERSHIP OF THE COMMISSION

SEC. 4.(a) The Commission shall be composed of twenty-five members, as follows:

(1) four members representative of the Federal government who shall be the Secretary of the Treasury, the Commissioner of Internal Revenue, the Secretary of Health, Education and Welfare, and the Director of the Office of Management and Budget;

(2) two members appointed by the President of the Senate, who shall be Members of the Senate;

(3) two members appointed by the Speaker of the House of Representatives, who shall be Members of the House;

(4) four members representative of state and local governments, two of whom shall be governors of states, appointed by the President of the United States from a panel of four submitted by the Governors' Conference, one of whom shall be a representative of the National Association of Attorneys General, appointed by the President from a panel of two submitted by that association, and one of whom shall be a representative of the American Municipal Association, appointed by the President from a panel of two submitted by that association;

(5) twelve members appointed by the President of the United States, all of whom shall be private citizens, three of whom shall represent the viewpoints of private donors and nine of whom shall represent the viewpoints of voluntary organizations and the beneficiaries of their services. The latter group shall include persons affiliated with a wide variety of organizations and all of the major areas of philanthropic activities such as education, health, social welfare, the arts and humanities, civic and public affairs, and religion; and

(6) the executive director of the Commission as appointed pursuant to subsection (b) of section 7 of this Act, who shall be a nonvoting member of the Commission.

(b) The members appointed from private life under paragraph (5) of subsection (a) shall be appointed without regard to political affiliation; of each class of members enumerated in paragraphs (2) and (3) of subsection (a), only one shall be from the majority party of the respective houses.

(c) The term of office of those classes of members enumerated in paragraphs (2), (3) and (4) of subsection (a) shall be two years. The term of office of the members appointed from private life under paragraph (5) of subsection (a) shall be three years, except that any member appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed only for the remainder of such term, and except that the terms of the office of such members first taking office shall expire, as designated by the President at the time of appointment, four at the end of the first year, four at the end of the second year and four at the end of the third year after the date of appointment. All members described in paragraphs (2), (3), (4) and (5) of subsection (a) shall be eligible for reappointment. Each member of the Commission shall serve in any event until his successor is appointed and qualified.

ORGANIZATION OF THE COMMISSION

SEC. 5.(a) The President shall convene the Commission within ninety days following enactment of this Act at such time and place as he may designate for the Commission's initial meeting.

(b) At its first meeting and from time to time thereafter, the Commission shall elect from among the members chosen from private life a Chairman and a Vice Chairman.

(c) Any vacancy in the membership of the Commission shall be filled in the same manner in which the original appointment was made.

(d) Where any member ceases to serve in the official position from which originally appointed under section 4(a), his place on the Commission shall be deemed to be vacant.

(e) Eight members of the Commission shall constitute a quorum.

DUTIES OF THE COMMISSION

SEC. 6. It shall be the duty of the Commission –

(1) to engage in such activities and to make such studies and investigations as are necessary or desirable in the accomplishment of the purposes set forth in section 2 of this Act;

(2) to submit an annual report to the President and the Congress on or before January 31 of each year. The Commission may also submit such additional reports to the President, to the Congress or any committee of the Congress, and to any unit of government or organization as the Commission may deem appropriate; and

(3) to convene once every two years a National Conference on the Private Voluntary Sector to foster the exchange of ideas, to promote the purposes of the private voluntary sector and to review, evaluate and advise on the activities of the Commission.

POWERS AND ADMINISTRATIVE PROVISIONS

SEC. 7.(a) In furtherance of its purposes the Commission is authorized to require the filing with it of such information reports by private voluntary organizations as it may prescribe and to establish a registry thereof. The Commission is authorized to set reasonable fees to be paid upon filing such reports and to set reasonable penalties for failure to file such reports, such fees and penalties to be collected and paid into the Treasury as miscellaneous receipts.

(b) The Commission shall have power to appoint, fix the compensation of, and remove an executive director without regard to the civil service laws or the Classification Act of 1949. Such appointment shall be made solely on the basis of fitness to perform the duties of the position and without regard to political affiliation.

(c) Each department, agency and instrumentality of the executive branch of the Government, including independent agencies, is authorized and directed to furnish to the Commission, upon request made by the Chairman, Vice Chairman or executive director, such information as the Commission deems necessary to carry out its functions under this Act.

(d) Subject to such rules and regulations as may be adopted by the Commission, the executive director, without regard to the civil service laws and the Classification Act of 1949, and without reference to political affiliation, shall have the power –

(1) to appoint, fix the compensation of, and remove such other personnel as he deems necessary,

(2) to procure temporary and intermittent services to the same extent as is authorized by section 15 of the Administrative Expenses Act of 1946 (5 U.S.C. 55a) but at rates not to exceed $_ a day for individuals.

(e) Except as otherwise provided in this Act, persons in the employ of the Commission under subsections (b) and (d)(1) of this section shall be considered to be Federal employees for all purposes, including –

(1) the Civil Service Retirement Act, as amended (5 U.S.C. 2251-2267),

(2) the Federal Employees' Group Life Insurance Act of 1954, as amended (5 U.S.C. 2091-2103),

(3) annual and sick leave, and

(4) the Travel Expense Act of 1949, as amended (5 U.S.C. 835-842).

(f) No individual employed in the service of the Commission shall be paid compensation for such employment at a rate in excess of the rate provided for grade 18 under the General Schedule of the Classification Act of 1949, as amended, except that the executive director of the Commission may be paid compensation at any rate not exceeding the rate prescribed for level III in the Federal Executive Salary Schedule of the Federal Executive Salary Act of 1964.

COMPENSATION OF COMMISSION MEMBERS

SEC. 8.(a) Members of the Commission who are Members of Congress or officers of the executive branch of the Federal Government and the executive director of the Commission shall serve without compensation in addition to that received in their regular public employment, but shall be allowed necessary travel expenses (or, in the alternative, a per diem in lieu of subsistence and mileage not to exceed the rates prescribed in the Travel Expense Act of 1949, as amended), without regard to the Travel Expense Act of 1949, as amended (5 U.S.C. 835-842), the Standardized Government Travel Regulations, or section 10 of the Act of March 3, 1933 (5 U.S.C. 73b), and other necessary expenses incurred by them in the performance of duties vested in the Commission.

(b) Members of the Commission, other than those to whom subsection (a) is applicable, shall receive compensation at the rate of $ __ per day for each day they are engaged in the performance of their duties as members of the Commission and shall be entitled to reimbursement for travel, subsistence, and other necessary expenses incurred by them in the performance of their duties as members of the Commission, as provided for in subsection (a) of this section.

ADVISORY COUNCIL

SEC. 9.(a)(1) For the purpose of advising and assisting the Commission with respect to its activities, there is hereby created a National Advisory Council on the Private Voluntary Sector, hereinafter referred to as the "Advisory Council," which shall consist of up to one hundred persons, not otherwise in the employ of the United States, appointed by the Commission without regard to the civil services laws.

(2) The membership of the Advisory Council shall include donors to private voluntary organizations, representatives of private voluntary organizations, State officials responsible for overseeing the activities of private voluntary organizations, and experts on the private voluntary sector.

(3) The Commission shall from time to time designate one of the members of the Advisory Council to serve as Chairman of the Advisory Council.

(4) Each member of the Advisory Council shall serve for a term of three years, except that any member appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed only for the remainder of such term, and except that the terms of the office of the members first taking office shall expire, as designated by the Commission at the time of appointment, one-third at the end of the first year, one-third at the end of the second year and one-third at the end of the third year after the date of appointment.

(5) A member of the Advisory Council shall not be eligible to serve continuously for more than two terms.

(b) Members of the Advisory Council, while attending meetings or conferences of the Advisory Council or otherwise serving on business of the Advisory Council, shall be entitled to receive compensation at rates fixed by the Commission, but not exceeding $ __ per day including travel time, and while serving away from their homes or regular places of business they may be allowed travel expenses, including per diem in lieu of subsistence, as authorized by section 5 of the Administrative Expenses Act for persons in the Government service employed intermittently.

(c) The Advisory Council shall meet at the request of the Commission, but at least annually, to discuss issues and problems suggested by the Commission as well as by its own membership. It shall have the opportunity to make recommendations for filling vacancies in the Commission.

AUTHORIZATION OF APPROPRIATIONS

SEC. 10. There are authorized to be appropriated such sums as may be necessary to carry out the provisions of this Act.

RECEIPT OF FUNDS

SEC. 11. The Commission is authorized to receive funds through grants, contracts and contributions from private voluntary organizations. Such funds may be received and expended by the Commission only for the purposes of this Act.

A STUDY OF THE INADEQUACIES OF PRESENT FINANCIAL REPORTING BY PHILANTHROPIC ORGANIZATIONS

Accounting Advisory Committee†

Introduction

Importance of Meaningful Financial Statements

Congress, state legislative bodies, and the public have indicated with increasing frequency that philanthropic organizations are public institutions and that their financial activities should be conducted in the full light of public scrutiny. Many believe that these organizations, because of their exempt tax status, have responsibility for disclosure equal to that of public, profit-seeking corporations. In a sense, a philanthropic organization has the general public as its shareholders.

An absence of meaningful financial information leads to concern about the use of charitable funds. This is periodically accented by newspaper headlines of improper use of contributed funds. Possibly, this has resulted in a reduction in the support which would have been available had there been more effective communication by philanthropic organizations.

In the Accounting Advisory Committee's opinion, private philanthropy cannot achieve its full potential without completely open, understandable financial reporting based upon uniform principles. The committee is concerned that if private philanthropy does not do a more effective job of financial reporting, regulatory bodies will increasingly assume responsibility to regulate philanthropic orgnizations. Inadequate reporting, including the absence of uniform accounting principles, will encourage governmental intervention and may lead to decisions regarding philanthropic goals being made more by government and less by the contributor.

The committee believes that the adoption and use of uniform accounting principles and reporting practices will better serve the contributor, protect the public interest, and facilitate the use of funds in areas where they are needed most. In addition to furnishing benefits to contributors and to government regulatory agencies, there will be other desirable results from improvement in financial reporting. Trustees and managers of philanthropic organizations will be better informed in making their decisions. The recipients of philanthropy will have a keener appreciation of the value of services received, particularly when they must pay a portion of its costs, as is the case with students who pay tuition. Also, the general public will better understand the scope of philanthropic services rendered and will have a basis for comparing the cost of services being rendered among similar type organizations.

Authoritative Pronouncements

Authoritative pronouncements relating to philanthropic organizations were developed initially by organized industry groups such as the National Association of College and University Business Officers, the American Hospital Association, the National Health Council, the National Assembly for Social Policy and Development, and the United Way of America. These organizations prepared manuals or other documents relating to accounting for the use of the related types of philanthropic organizations.

---

† Members: Malvern J. Gross, Jr., CPA, chairman; R. Kirk Batzer, CPA; Delford W. Edens, CPA; Timothy J. Racek, CPA.
Staff: Martin F. Baumann, CPA; John J. O'Leary, CPA; Richard L. Spædt, CPA; Frank T. VanMorrelgem, CPA.

For many years the public accounting profession paid little attention to the development of accounting principles for these organizations. The pronouncements of the Accounting Principles Board (APB), which exercised primary rule-making authority in the accounting profession prior to June 30, 1973, were directed almost entirely to accounting for organizations organized for profit. However, the APB did approve, in 1972 and 1973, the issuance of three AICPA industry audit guides for hospitals, for colleges and universities, and for voluntary health and welfare organizations. These guides were prepared by committees consisting of accountants in public practice and those in the related philanthropic organizations. The guides were a significant step forward in identifying accounting principles and improving financial reporting. However, there are differences among the guides in recommended accounting principles in several areas. The Financial Accounting Standards Board (FASB) succeeded the APB as the primary rule-making body in the accounting profession on June 30, 1973, and has not yet considered isssues directly affecting philanthropic organizations.

In addition to the audit guides, a number of industry groups have published or are in the process of publishing accounting manuals which are also authoritative. (Among the major manuals falling in this category are *The Administrative Service* published by the National Association of College and University Business Officers; *Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations* (revised), published jointly by the National Health Council, The National Assembly of Voluntary Health and Social Welfare Organizations, and the United Way of America; *Accounting and Financial Reporting—A Guide for United Ways and Not-For-Profit Human Service Organizations* published by the United Way of America.) For the most part these manuals are consistent with the audit guides and serve to provide detailed direction in the application of the accounting principles and reporting formats in the audit guides. Several of these manuals also provide direction with respect to procedures for allocation of expenses to functional categories.

The committee in its efforts to identify accounting principles uniformly applicable to philanthropic organizations has necessarily expressed conclusions which are at variance with one or more of the audit guides. To this extent, organizations following principles recommended by the committee which are at variance with the audit guides must recognize that their CPA may be called upon to justify departures from audit guide recommendations.

Scope of Study

The work of the Accounting Advisory Committee has encompassed the following:

1. A study of the adequacy of present accounting principles and reporting practices followed by each major type of philanthropic organization in financial reporting to the public.

2. A study of the desirability and practicability of establishing a single set of accounting principles and reporting practices for all categories of philanthropic organizations.

3. A survey of present federal and state regulatory financial reporting requirements and the extent to which uniform reporting exists.

4. A study of the basic financial information appropriate for regulatory reporting.

The Accounting Advisory Committee consists of individuals, knowledgeable in the field of nonprofit accounting, from four public accounting firms. They are serving on this committee as individuals and not as representatives of their respective firms, the AICPA, nor of any other professional accountancy body. As such, the views expressed in this report are those of the four individuals on the committee.

Summary of Conclusions and Recommendations

The committee has reached the following conclusions which are discussed in more detail later in this report:

1. Present financial reporting to the public by philanthropic organizations requires substantial improvement.

2. Alternative accounting principles now exist from which most philanthropic organizations may choose. Accordingly, transactions handled in one way by an organization may be handled in a different way by another. Furthermore, even the three existing official pronouncements of the American Institute of Certified Public Accountants (AICPA) (Industry Audit Guides applicable to hospitals, to college and universities, and to voluntary health and welfare organizations) are not completely uniform in the accounting principles and reporting practices which they prescribe.

3. The federal government, more than half of the states, and many municipalities have financial regulatory reporting requirements for philanthropic organizations. However, many of these jurisdictions have their own reporting formats which gives rise to needless expense for philanthropic organizations in preparing the different reports.

4. The basic financial information required by the various regulatory agencies could be improved in the interests of fairness of presentation, clarity, and uniformity.

These conclusions are the result of extensive research and deliberations by the committee. We believe they are significant and important to the long-range growth of private philanthropy in the United States. As such, they call for specific action, and consequently we recommend the following:

1. A single, uniform set of accounting principles, including those recommended by the committee in this report, should be adopted and followed by *all* philanthropic organizations.

2. A uniform financial report should be adopted by the federal government and each state and municipality which now requires annual financial information from philanthropic organizations. We propose a Standard Accounting Report (SAR), as illustrated in Chart 3 of this report, which could be used for this purpose with appropriate supplemental schedules for other information deemed necessary to fulfill the particular regulatory interest.

I

FINANCIAL REPORTING FOR PHILANTHROPIC ORGANIZATIONS

Present Financial Statements are Difficult to Comprehend

The financial statements of many philanthropic organizations are difficult to understand for the reader not familiar with the specialized accounting principles and reporting practices followed by such organizations. This difficulty results largely from the historic "stewardship" approach to accounting for funds given to such organizations for designated purposes. This stewardship approach is usually referred to as "fund accounting," a system of accounting in which separate records are kept for funds given to an organization for a specific purpose. Typically, fund accounting results in separate self-balancing "funds" for each major type of resource available to the organization and often the financial statements consist of a series of separate statements, one for each fund group. In some organizations, separate funds are set up for each major gift, *and* separate statements are prepared for each. This can result in a proliferation of financial statements, often without any summary for the entity as a whole.

The reader is confronted with a further problem in looking at financial statements of philanthropic organizations because of the difference in goals of these organizations compared with commercial enterprises. A principal objective of a philanthropic organization is to provide a socially needed product or service by spending its resources on its program objectives, whereas a principal objective of a profit-oriented organization is to generate net income for its owners. "Net income" for a commercial organization is a significant measure of success whereas a philanthropic organization may be most efficient from a financial standpoint when income and expense are equal. Further, there is presently no way for a philanthropic organization to fully quantify the effectiveness of a particular program in its financial statements. As a result, there is a reporting tendency to merely "account" for amounts received and expended. The commitee recognizes that financial reporting would be improved if the effectiveness of philanthropic effort could be measured, but it has considered this subject to be beyond the scope of its work.

Another difficulty in understanding financial statements of philanthropic organizations is the absence of a single set of clearly defined accounting principles for use by all types of organizations. The accounting profession has acted officially with respect to only three of the eight types of organizations studied by the committee and even on these three the pronouncements are not consistent as to several accounting principles or in the reporting formats.

A further consideration is the recognition that from a fund-raising standpoint there may be a desire to project the appearance of financial hardship. Fund accounting techniques and the resulting reporting presentations may make it difficult for the public to evaluate the needs of the organization. On the other hand, the public increasingly demands to see statements that are complete and understandable.

Present Accounting and Reporting Practices are Subjective and Varied

The committee reviewed representative samples of financial reports for eight types of philanthropic organizations to determine the accounting principles and financial reporting practices currently being followed. This research disclosed a wide variety of practices both among the industry types and, in certain cases, within the types.

The committee has limited its report and conclusions to those issues which it believes are the most important and as to which there is diversity in practice. Other issues are important in certain circumstances, but the committee concluded that existing literature on these issues was sufficiently clear or that they had less general application. Chart 1 summarizes the key accounting and reporting issues and the present practice for each type of organization.

A Single, Uniform Set of Accounting Principles Should Be Adopted

The committee believes that a single, uniform set of accounting principles should be adopted and followed by all philanthropic organizations. There are several reasons for this conclusion:

1. Use of the same basic accounting principles and reporting practices would facilitate comparison of financial statements of different organizations. As is pointed out in the Trueblood Report ("Objectives of Financial Statements" published by the American Institute of Certified Public Accountants, October 1973):

   "The essence of economic decisions is choice among possible courses of action. Choice requires awareness of the opportunities offered by alternatives. Financial information should facilitate the comparisons needed to make investment and other decisions."

   Only by having all philanthropic organizations employ the same principles can this be possible.

2. Use of a single set of basic accounting principles and reporting practices will make it easier for the nonaccountant to comprehend the statements and for the organization to communicate its financial information.

3. Following the same basic accounting principles and reporting practices will result in more objective reporting and the reader will be less likely to draw unwarranted conclusions.

4. Finally, following the same basic accounting principles and reporting practices is recommended because it "makes sense." The committee can find little logic in the view that each type of philanthropic organization should handle its accounting and reporting without regard to a common set of principles.

The committee recognizes the need for organizations to have sufficient flexibility in preparation of their financial statements to adequately communicate the unique circumstances applicable to their respective operations. Clearly, complex organizations such as hospitals and colleges face a greater challenge in this regard than do local civic associations or church groups. On the other hand, there are numerous small philanthropic organizations for whom complex accounting procedures may be neither practical nor economical, and for whom a form of reporting based essentially on cash receipts and disbursements may be adequately informative.

The committee's conclusions as to reporting practices are directed to financial statements issued to the public. Other financial statements such as those reflecting changes in cash, comparisons with budget, and compliance with loan agreements may also be essential for management and other purposes. By recommending the adoption of uniform accounting principles and reporting practices, the committee is urging that similar transactions be treated in a similar way and that the *concepts* underlying financial statement preparation be uniform.

Chart 1

Summary of Current Accounting and Public Reporting Practices and Committee's Conclusions

Issues	Predominately followed present practice		
	Hospitals(1)	Voluntary health and welfare organizations(1)	Colleges and universities(1)
1. Is accrual basis accounting followed (versus cash basis accounting)?	Yes	Yes	Yes
2. Do the financial statements include "total all funds" figures (versus reporting on the separate funds only):			
a. in the "Balance Sheet"?	No	No	No (4)
b. in the "Statement of Revenue, Expenses and Changes in Fund Balances"?	No	In part	No (4)
3. Do the financial statements clearly show the "excess (deficit) of support, revenue and other additions over expenses and other deductions" (versus either not showing such a figure or reporting it in an unclear manner): (2)			
a. for unrestricted funds?	Yes	Yes	No
b. for restricted funds?	No	Yes	No
c. for "total all funds"?	No	No	No
4. Are all transfers between funds reported after the "excess (deficit) of support, revenue and other additions over expenses and other deductions" caption (versus reporting them before the "excess" caption)?	Yes	Yes	No
5. Are all unrestricted funds reported together (versus reporting board-designated funds separately)?	Yes	Yes	No
6. Are all gifts and bequests reported in one statement as "support, revenue and other additions" (versus being reported in a manner that the total of gifts and bequests is not readily ascertainable):			
a. for unrestricted funds?	Yes	Yes	Yes
b. for restricted funds?	No	Yes	Yes (4)
7. Is all interest and dividend income reported in one statement as "support, revenue and other additions" (versus being reported in a manner that the total of interest and dividend income is not readily ascertainable):			
a. for unrestricted funds?	Yes	Yes	Yes (4)
b. for restricted funds?	No	Yes	Yes (4)

(1) For these organizations, the Committee has considered the illustrative financial statements in the respective AICPA Audit Guide to be the predominantly followed present practice. For colleges and universities, the Committee has considered the Statement of Changes in Fund Balances (Exhibit B in the Audit Guide) expanded to show the unrestricted revenues by source, as provided on page [illegible], to be the equivalent of the Statement of Revenue, Expenses and Changes in Fund Balances.

(2) The use of the words "other additions" refers to certain assets coming from sources outside the organization and not from interfund transactions. The words "other additions" are used here because many believe that endowment and other restricted gifts are not support or revenue as such but are additions to the fund balance. The Committee does not object to the use of this terminology provided these "other additions" are presented in a clear manner as recommended in the SAR presented in Chart III.

Chart 1 (Continued)

Community organizations	Cultural organizations	Research and scientific organizations	Churches	Private foundations	Summary of Committee's Conclusions (see Chart 2)
Yes	Yes	Yes	No	Both	Follow accrual basis accounting
No	No	No	No	No	Include total all funds figures (3)
Both	Both	No	No	No	
Both	Both	Yes	No	Both	Show the excess of support, revenue and other additions over expenses and other deductions
No	No	Yes	No	No	
No	No	No	No	No	Show the excess of support, revenue and other additions over expenses and other deductions (3)
Yes	Yes	No	Both	Yes	Report transfers between funds after the excess (deficit) of support, revenue and other additions over expenses and other deductions caption
Yes	Both	Both	No	Both	Report all unrestricted funds together
Yes	Both	Yes	Both	Both	Report all gifts and bequests in one statement as support, revenue and other additions
Yes	Both	Yes	No	Both	
Yes	Yes	Yes	Yes	Yes	Report all interest and dividend income in one statement as support, revenue and other additions
Both	Both	Both	Yes	Yes	

(3) The Committee is not in unanimous agreement on this issue.

(4) The alternative treatment is specifically permitted by the AICPA Audit Guide.

(5) The financial statement disclosure of this issue was generally insufficient to enable the Committee to reach a conclusion as to the predominately followed present practice.

(6) A significant minority follows the alternate treatment.

Chart 1 (Continued)

Issues	Predominately followed present practice		
	Hospitals(1)	Voluntary health and welfare organizations(1)	Colleges and universities(1)
8. Are all capital gains and losses reported in one statement as "support, revenue and other additions" (versus being reported in a manner that the total of capital gains and losses is not readily ascertainable):			
a. for unrestricted funds?	Yes	Yes	Yes (4)
b. for restricted funds?	No	Yes	Yes (4)
9. Are restricted contributions which are currently spendable reported as "support, revenue and other additions" in the period received (versus being so reported only when expended)?	No	Yes	Yes
10. Are pledges reported as assets in the financial statements (versus not being reported until collected)?	Yes	Yes	No (4)
11. Are contributed services valued and recorded, where appropriate (versus ignoring their value)?	Yes	Yes	Yes
12. Are fixed assets capitalized (versus being written off when purchased)?	Yes	Yes	Yes
13. Are capitalized fixed assets depreciated (versus not being depreciated)?	Yes	Yes	No (4)
14. Is a separate plant fund used for reporting fixed assets (versus including fixed assets with the unrestricted fund)?	No	Yes	Yes
15. Are investments carried at market—fair value (versus being carried at cost)?	No	No (4)	No (4)
16. Do the financial statements include a functional reporting of expenses (versus only reporting such expenses in natural classifications—salaries, occupancy, utilities, etc.):			
a. for each major program service category?	Yes	Yes	Yes
b. for fund-raising costs?	No	Yes	No
c. for administrative costs?	Yes	Yes	Yes

Recommended Accounting Principles and Reporting Concepts

As previously noted, present financial statements are often difficult to comprehend due to a strict adherence to the traditional concepts of fund reporting. The committee reaffirms the need to clearly disclose the existence and extent of contributor restrictions on the use of resources for program accomplishment, endowment or other restricted purposes. However, when an organization reports each of its funds in separate statements or on separate pages, it is difficult for the reader to comprehend the overall financial picture of the organization. For this reason the committee recommends that all funds be reported on each page of a financial statement, preferably in a columnar format. The form of financial statements reflects this concept (see Chart 3).

Chart 2 reflects the key accounting and reporting issues applicable to philanthropic organizations, the significance of each issue, the various alternative practices which are followed, the rationale for each alternative, and the committee's conclusions.

Chart 1 (Continued)

Community organizations	Cultural organizations	Research and scientific organizations	Churches	Private foundations	Summary of Committee's Conclusions (see Chart 2)
Yes	Yes	Yes	Both	No	Report all capital gains and losses in one statement as support, revenue and other additions
Both	Both	Both	No	No	
(5)	Yes	Both	No	No	Report restricted contributions, which are currently spendable, when received. (3)
(5)	(5)	(5)	No	(5)	Report estimated collectible amount of pledges in the financial statements.
(5)	(5)	(5)	No	No	Value and record contributed services, where appropriate
No	No	Yes	Both	No	Capitalize fixed assets.
N/A	N/A	Both	No	N/A	Depreciate fixed assets.
No	No	No	Yes	No	Use a separate plant fund for reporting fixed assets. (3)
No	No	No	No	No (6)	Carry investments at market — fair value
No	Both	Both	Both	Both	Report expenses on a functional basis in the financial statements.
No	No	No	No	N/A	
No	Both	Both	No	Both	

Summary

In concluding with respect to the objectives of financial statements for not-for-profit organizations, the AICPA Study Group on the Objectives of Financial Statements stated that: "An objective of financial statements for governmental and not-for-profit organizations is to provide information useful for evaluating the effectiveness of the management of resources in achieving the organization's goals. Performance measures should be quantified in terms of identified goals."

This statement, when considered with what the Study Group found to be the basic objective of financial statements— ". . . to provide information useful for making economic decisions"—clearly summarizes the conclusions of the committee regarding accounting and reporting for philanthropic organizations. Only through meaningful financial reporting, following uniform accounting principles, can potential contributors and regulators evaluate the financial activities of a philanthropic organization. The benefits to management, to the recipients of services, and to the public are also substantial, as has been previously described. The economic decision of a contributor as to whether a donation should be made may depend, among other things, on how well management has utilized the available resources in achieving the organization's goals. The committee believes that use of the accounting principles and reporting practices that are being recommended should significantly help to accomplish this meaningful financial reporting.

Chart 2
SUMMARY OF ISSUES: ACCOUNTING AND PUBLIC REPORTING

Issue	Significance of Issue	Arguments in Favor of Each Alternative	Committee's Conclusion
1. Is accrual basis accounting followed (versus cash basis accounting)?	Should financial statements reflect all transactions and economic events for the period, or only those that affect cash?	Accrual basis accounting: (1) Statements more accurately present the necessary financial information. (2) Cash basis statements can be significantly affected by the timing of cash receipts and disbursements. (3) Accrual basis is "generally accepted" for other types of organizations, and is generally understood by business people. Cash basis accounting: (1) Easier to maintain bookkeeping records. (2) In many cases, differences between cash and accrual are not significant. (3) Less confusion over cash resources available for future use. (4) Requires no reconciling with cash budgets.	The committee concludes that accrual basis accounting should be followed.
2. Do the financial statements include "total all funds" figures (versus reporting on the separate funds only) a. in the "Balance Sheet"? b. in the "Statement of Revenue, Expenses and Changes in Fund Balances"?	Should all of the resources and activities of the entity as a whole be reported in a combined manner? Are the various restricted funds part of the "net worth" or fund balances of the organization or are they merely held by the organization pending expenditure? If they are not part of the "net worth," should these restricted funds be reported in a manner suggesting they are part of the "net worth" or fund balances?	Including "total all funds" figures: (1) A philanthropic organization is a single entity, not a series of separate entities called funds. (2) It is difficult for the reader to comprehend the overall picture when statements are presented on only a separate fund-by-fund basis. Reporting separate funds only: (1) The organization cannot freely spend endowment and other restricted funds and by reporting "total all funds" figures the reader may be mislead into thinking it can do so. (2) Even with a multicolumn presentation, the reader may focus only on the total column. (3) The "total all funds" information has no meaning because of restrictions on many funds, and only separate fund reporting is relevant.	Messrs. Batzer, Gross and Recek conclude that total all funds information is appropriate provided the separate funds are also presented. Mr. Edens believes that there are instances where such total all funds information could be misunderstood.
3. Do the financial statements clearly show the "excess (deficit) of support, revenue and other additions over expenses and other deductions" (versus either not showing such a figure or reporting it in an unclear manner):* a. for unrestricted funds? b. for restricted funds? c. for "total all funds"?	Is it appropriate for philanthropic organizations to report an "excess" caption which shows the results of activities for a period? Or, is the nature of these organizations such that all they should be reporting are the increases and decreases in fund balances without clearly reporting the net result for the period?	Reporting the "excess" caption: (1) There is significance to this caption since ultimately the organization must take in as much as it spends or it may go bankrupt. (2) This figure is significant to a contributor in measuring the need of the organization for his contribution. (3) The inclusion of this figure tends to make the financial statements more cohesive and understandable. (4) This is the single most significant figure in determining the relationship of all expenses to support and revenue. Not reporting the "excess" caption: (1) Philanthropic organizations are not profit-oriented and there is no significance to this figure. (2) Many may draw unwarranted conclusions by reason of an excess or deficit. (3) A large "excess" may discourage potential contributors. (4) Many consider restricted funds and endowment funds as merely being held in custody by a philanthropic organization for specific purposes. As such, an "excess" caption for these funds would be misleading.	Messrs. Batzer, Gross and Recek conclude that an excess caption is appropriate for each fund, and for the total all funds where the separate funds are also shown. Mr. Edens agrees that an excess caption is appropriate for the individual funds but expresses concern that an excess caption for the total all funds could be misunderstood.
4. Are all transfers between funds reported after the "excess (deficit) of support, revenue and other additions over expenses and other deductions" caption (versus reporting them before the "excess" caption)?	Are transfers between funds "support" or "revenue" to the receiving fund and "expense" to the transferring fund, or are such transfers neither support, revenue, nor expenses? Implicit in this issue is the question of whether an organization should be reporting on a fund-by-fund basis or on the entity as a whole.	Reporting transfers after the "excess" caption: (1) The "excess" should reflect only the net result of all transactions with third parties. Transfers represent internal allocations of funds and thus should not be reflected as support, revenue or expense. (2) This is the least confusing presentation to the nonaccountant reader. (3) Keeps management from arbitrarily determining the "excess" amount for any fund. Reporting transfers before the "excess" caption: (1) Each fund is separate and a transfer represents either support, revenue or expense to the individual fund. (2) The Board should have maximum freedom to communicate the organization's economic situation after providing for future needs.	The committee concludes that all transfers between funds should be reported after the excess (deficit) of support, revenue and other additions over expenses and other deductions.

*The use of the words "other additions" refers to certain assets coming from sources outside the organization and not from interfund transactions. The words "other additions" are used here because many believe that endowment and other restricted gifts are not support or revenue as such but are additions to the fund balance. The committee does not object to the use of this terminology provided these "other additions" are presented in a clear manner as recommended in the FAP presented in Chart 3.

Chart 2 (Continued)

Issue	Significance of Issue	Arguments in Favor of Each Alternative	Committee's Conclusion
5. Are all unrestricted funds reported together (versus reporting board-designated funds separately)?	Should a philanthropic organization be permitted to report its unrestricted resources in separate funds classified by the intended use to be made of these funds? Should the organization report the total of its unrestricted resources together, or can the organization report its unrestricted resources in separate subfunds classified by intended use without such total?	Reporting all unrestricted funds together: (1) The board has control over unrestricted funds and should report all of its available unrestricted resources together. (2) Separate board-designated funds are confusing to many readers. (3) Intentions of the board as to future use of unrestricted funds can be adequately set forth while reporting all such funds together. Reporting board-designated funds separately: (1) The board is in the best position to know how it intends to use unrestricted resources and the statements should reflect this intent.	The committee concludes that all unrestricted funds should be reported together.
6. Are all gifts and bequests reported in one statement as "support, revenue and other additions" (versus being reported in a manner that the total of gifts and bequests is not readily ascertainable): a. for unrestricted funds? b. for restricted funds?	This issue relates to the question of whether gifts and bequests should be reported in one statement for the period or whether certain gifts and bequests may be separately reported as direct additions to the fund balance after determining the excess (deficit) for the year.	Reporting all gifts and bequests in one statement: (1) The reader may not realize that contributions were received if such gifts were not reported in one statement. (2) This method presents the most meaningful financial information to the reader. Reporting some gifts and bequests separately: (1) Restricted gifts in particular should be separately added to the related fund balance and not reported as "support, revenue and other additions" because these gifts are restricted for given purposes and thus not "earned" until the restrictions have been met. (2) Gifts and bequests fluctuate greatly from year to year and including them with "support, revenue and other additions" will cause fluctuations without reference to costs.	The committee concludes that all gifts and bequests should be reported in one statement as support, revenue and other additions.
7. Is all interest and dividend income reported in one statement as "support, revenue and other additions" (versus being reported in a manner that the total of interest and dividend income is not readily ascertainable): a. for unrestricted funds? b. for restricted funds?	This issue relates to the question of whether all investment income (dividends and interest) should be reported in one statement for the period of whether certain investment income (dividends and interest) may be separately reported as direct additions to the fund balance after determining the excess (deficit) for the year.	Reporting all investment income in one statement: (1) The reader may not realize that investment income was received if such amounts were not reported in one statement. (2) This method presents the most meaningful financial information to the reader. Reporting some investment income separately: (1) Restricted investment income in particular should be separately added to the related fund balance and not reported as "support, revenue and other additions" because these amounts are restricted for given purposes and thus not "earned" until the restrictions have been met.	The committee concludes that all interest and dividend income should be reported in one statement as support, revenue and other additions.
8. Are all capital gains and losses reported in one statement as "support, revenue and other additions" (versus being reported in a manner that the total of capital gains and losses is not readily ascertainable): a. for unrestricted funds? b. for restricted funds?	This issue relates to the question of whether all capital gains and losses should be reported in one statement for the period or whether certain capital gains and losses may be separately reported as direct additions to the fund balance after determining the excess (deficit) for the year.	Reporting all capital gains and losses in one statement: (1) Capital gains and losses and investment income (interest and dividends) reflect the investment management policy of the organization. Either policy (emphasis on current income or capital appreciation) can be emphasized, usually at the expense of the other. (2) Reporting capital gains and losses in a manner different from interest and dividends would only serve to confuse the readers. Reporting some capital gains and losses separately: (1) Traditionally capital gains and losses have been thought of as adjustments of principal. (2) Capital gains and losses in part result from inflation, and should not be considered similar to interest and dividends. (3) In some states, capital gains on endowment funds may not be used for current purposes suggesting these amounts should be reported in a manner different than capital gains which are available.	The committee concludes that all capital gains and losses should be reported in one statement as support, revenue and other additions.

Chart 2 (Continued)

Issue	Significance of Issue	Arguments in Favor of Each Alternative	Committee's Conclusion
9. Are restricted contributions which are currently spendable reported as "support, revenue and other additions" in the period received (versus being so reported only when expended)?	Are restricted contributions which are currently spendable an increase in an organization's "net worth" or fund balances, or are they deferred revenue which should be held in suspense until the restrictions have been fulfilled?	Reporting when received: (1) This reflects the economic reality of the transaction. (2) The organization would not have accepted the contribution if it did not intend to use it for the purposes indicated. (3) Clearly reports all funds available for program purposes. Reporting when expended: (1) The restriction is not met until the funds are spent, therefore they should be recorded as deferred revenue until that time. (2) If not spent for the restricted purposes these contributions may have to be refunded.	Messrs. Batzer, Gross and Rocek believe that restricted contributions which are currently spendable should be reported as support, revenue and other additions in the period when received. Mr. Edens believes that restricted contributions which are currently spendable should be reported as deferred revenue until expended.
10. Are pledges reported as assets in the financial statements (versus not being reported until collected)?	Are pledges assets which should be recognized?	Recording pledges: (1) Pledges are assets of value to the organization and excluding them distorts the statements. (2) The degree of collectibility of pledges is usually predictable. (3) The absence of legally enforceable claims is irrelevant if experience shows that pledges will be collectible. (4) Follow-up work on pledges may be improved and collection enhanced when pledges are under accounting control. Not recording pledges: (1) They may not be legally enforceable. (2) It may be difficult to estimate the amount of pledges that will be collected. (3) The bookkeeping may be somewhat complicated.	The committee concludes that the estimated collectible amount of pledges should be reported as assets in the financial statements.
11. Are contributed services valued and recorded, where appropriate (versus ignoring their value)?	Volunteers are frequently a vital part of an organization's ability to carry out its program objectives. Should those services be valued and reflected in the statements?	Recording the value of contributed services: (1) If such services are important to the organization then they should be reflected in the financial statements. (2) Comparability among organizations is distorted if not recorded. (3) Recognizes the importance of volunteers to the organizations by placing a value on their time. Ignoring the value of contributed services: (1) It is difficult to place a value on the services of volunteers. (2) Detailed records have to be maintained to accumulate time of volunteers. (3) Few organizations record such amounts.	The Committee concludes that contributed services should be valued and recorded in the financial statements provided the following criteria as prescribed in the Audit Guide for Voluntary Health and Welfare Organizations have been met: (i) The value of such services is significant. (ii) The services performed are a normal part of the program or supporting services and would otherwise be performed by salaried personnel. (iii) The organization exercises control over the employment and duties of the donors of the services. (iv) The organization has a clearly measurable basis for the amount.
12. Are fixed assets capitalized (versus being written-off when purchased)?	Should the balance sheet include fixed assets, thus fully reflecting management's accountability, or are fixed assets so different from other types of assets held by philanthropic organizations that they should be excluded? Related to this, should fixed assets be charged as an expense as purchased—the consequences of not capitalizing?	Capitalizing fixed assets: (1) Shows the organization's accountability and the resources available to the board for use in carrying out the programs. (2) Presents a more comparable statement of activity from period to period, not distorted by a large acquisition in any one period. (3) Permits allocation of the cost of fixed assets to program activities over periods benefited by these assets. (4) Capitalizing fixed assets is "generally accepted" for other types of organizations, and is generally understood by business people.	The committee concludes that fixed assets should be capitalized.

Chart 2 (Continued)

Issue	Significance of Issue	Arguments in Favor of Each Alternative	Committee's Conclusion
12. (contd.)		Writing off fixed assets when purchased: (1) Easier from a bookkeeping standpoint. (2) Easier to understand for most nonaccountants. (3) Reduces the fund balance and thus lessens the likelihood that the reader will conclude that the entire fund balance is available for current use. (4) Relates the expenditure for fixed assets to plant fund contributions. (5) Relates the charge for the fixed asset to the period when the purchase was made.	
13. Are capitalized fixed assets depreciated (versus not being depreciated)?	Should an organization be reporting its cost of program and supporting services? If yes, then depreciation must be considered since it also is a "cost." Alternatively, should an organization be reporting only its "cash" cost, in which case depreciation is not a factor?	Depreciating fixed assets: (1) There is an increased public emphasis on measuring the cost of services being rendered. (2) Depreciation is a technique to allocate the cost of an asset over its useful life. The usefulness of fixed assets to an organization is finite and the asset's cost should be allocated over this period. (3) The source of fixed assets, whether a gift or purchase, is irrelevant in measuring the cost of using the fixed asset. (4) Depreciating fixed assets is "generally accepted" for other types of organizations, and is generally understood by business people. Carrying fixed assets at cost: (1) Depreciation does not involve an outlay of cash and thus does not have the appearance of an expense of the period. (2) Fixed assets often increase in value rather than decline. (3) Depreciation is a complicated bookkeeping concept for the layman to understand. (4) When a contributor has given to a building fund, it appears that the organization may be recording costs twice—once when the building is constructed and again when depreciation is reported as a cost.	The committee concludes that fixed assets should be depreciated.
14. Is a separate plant fund used for reporting fixed assets (versus including fixed assets with the unrestricted fund)?	At issue is the nature of the unrestricted fund. Many believe that the unrestricted fund should be presented as two funds—the portion currently spendable for program purposes, and the portion invested in fixed assets. This allows the reader to see the funds currently available without the confusion of fixed assets being included in the unrestricted fund. Also, should the organization continue to carry in a restricted fund those fixed assets purchased in whole or part with restricted contributions?	Reporting fixed assets in a separate plant fund: (1) Fixed assets cannot be spent for current purposes and should thus be classified separately. (2) Provides a clearer presentation of the resources available for program purposes. (3) Avoids the question of carry-over of restrictions on fixed assets where purchased with restricted funds. (4) Keeps depreciation—a noncash transaction—out of the unrestricted fund. Including fixed assets with the unrestricted fund: (1) There are only two types of funds—unrestricted and restricted. Artificially separating unrestricted funds is confusing. (2) The depreciation charge should be in the unrestricted fund where all other current expenses are reported. (3) Because fixed assets are not likely to be sold, the restrictions carry-over point is moot.	Messrs. Betzer, Edens and Recok conclude that fixed assets should be reported in a separate plant fund, while Mr. Gross believes that it is usually more appropriate to include fixed assets with the unrestricted fund.
15. Are investments carried at market—fair value (versus being carried at cost)?	There are often wide variations between the cost of investments and their current value, and this issue questions which valuation method gives the more meaningful picture of financial position.	Carrying investments at market—fair value: (1) Gives the reader a better indication of the resources available to the organization. (2) Shows the current value of amounts which may be utilized. (3) More accurately reflects the organization's "net worth." (4) This is the accepted method for investment companies, which have investments as their principal asset. (5) Provides a better indication of investment performance. Carrying investments at cost: (1) When market values fluctuate, carrying investments at market causes results of activity to vary significantly from year to year.	The committee concludes that investments, exclusive of fixed assets held for use in the organization's program, should be carried at market—fair value.

Chart 2 (Continued)

Issue	Significance of Issue	Arguments in Favor of Each Alternative	Committee's Conclusion
15. (contd.)		(2) Unrealized gains and losses should not be recognized as a result of a temporary fluctuation of an investment's market value. (3) The cost basis has historically been conservative. (4) The cost basis is the "generally accepted" method for most other types of enterprises and is generally understood by business people.	
16. Do the financial statements include a functional reporting of expenses (versus only reporting such expenses in natural classifications—salaries, occupancy, utilities, etc.) a) for each major program service category? b) for fund-raising costs? c) for administrative costs?	Should an organization allocate and report its expenses in terms of its program services so the reader will have a financial basis for judging the effectiveness of the organization? Is there an appropriate allocation of costs among program services, fund raising, and general and administrative expenses?	Reporting expenses on a functional basis: (1) Unless an organization classifies expenses by major program services, it is not possible to have a financial basis for an evaluation of the degree to which an organization is achieving its charitable purposes. (2) Many organizations conduct substantial program activities with their own staff, whereas others conduct program activities principally through grants to individuals or other organizations. The reader cannot make adequate comparisions of the cost of program services of such dissimilar organizations without a functional classification of expenses. (3) The functional reporting of expenses enables the reader to relate fund raising and administrative costs to total proceeds from fund raising campaigns, to total revenue and to program costs. Not reporting expenses on a functional basis: (1) Functional classification involves numerous allocations of expenses, particularly where individuals are involved in more than one function. Many such allocations are made on an arbitrary basis and may be of dubious value. (2) Accumulation of the data needed for functional statements involves additional administrative cost.	The committee concludes that expenses should be reported on a functional basis in the financial statements.

II

FEDERAL AND STATE REGULATORY REPORTING

Jurisdictions Have Different Reporting Requirements

At present, 26 states have financial regulatory reporting requirements in addition to those required by the Internal Revenue Service and by a number of municipalities. Typically, the form of reporting is legalistic in nature, and while it contains substantial financial information, it is seldom in a financial statement format similar to that used by philanthropic organizations in their published reports. For the most part, each jurisdiction has developed its own reporting format and accounting requirements with the result that many organizations find that they are reporting the same transaction differently. Philanthropic organizations with fund-raising activities that are national in scope are usually required to comply with these requirements in many jurisdictions.

Usefulness of Financial Information in State Reports

The financial statements contained in many of the state regulatory reports are incomplete from an accounting standpoint and appear to have been designed specifically to respond to limited legal requirements. The committee believes that such regulatory bodies should make available to the public financial statements of philanthropic organizations that clearly disclose their fiscal activities; it is highly questionable that this objective is being accomplished by many of these regulatory forms.

Usefulness of Financial Information in Federal Reports

All tax-exempt organizations other than churches and organizations with gross receipts of less than $5,000 must file IRS Form 990 or a related from. For this reason, this form has a major impact on philanthropic organizations. As with the state reporting forms, this form is not financial-statement oriented but is directed to regulatory needs.

A deficiency in the Form 990 from the standpoint of financial reporting is its failure to recognize the fund accounting concept which philanthropic organizations follow. The result is that organizations must report both restricted and unrestricted funds in single column financial statements. In many instances, such financial statements could be misleading since they would not adequately communicate the restrictions on use of resources.

The committee has studied the Internal Revenue Code to determine how much of the information presently required on Form 990 is specifically mandated by legislation. It was found that the statutory authority for Form 990 is very broadly worded and gives the IRS authority to specify desired information by regulations and forms. Accordingly, modifications in the format of financial statements included in the present Form 990 could probably be made along the lines recommended below without legislative action.

While the IRS Form 990 may be well conceived from the standpoint of highlighting financial data pertinent to determination of qualification for exempt status and taxability of nonexempt activities, the financial statements included in this form are incomplete from a financial reporting standpoint.

Recommended Standard Accounting Report (SAR)

The proliferation of financial reporting formats for regulatory reporting is not in the best interests of the affected charities, the regulatory groups, or the public. Aside from the inherently wasteful expenditure of contributed funds to prepare these various reports, most fail to accomplish the basic communication objective of financial statements. The committee believes that the public interest would be best served by the adoption of a basic uniform financial report for use by all regulatory groups. To the extent appropriate, each jurisdiction might supplement the required basic financial statements with data specifically relating to its particular regulatory interests. This would permit each agency to better fulfill its regulatory objectives since the reported financial data would be presented in a uniform manner permitting more meaningful analysis and comparison. In addition, the adoption of the SAR at this time will coincide with the establishment of a new IRS Office of Employee Plans and Exempt Organizations as provided for in the Employee Retirement Income Security Act of 1974. This office, among other things, will administer the tax provisions applicable to exempt organizations.

Since the IRS Form 990 is the most widely used form, a copy of its basic financial statement section, if modified along the lines incorporated in the SAR, could serve as the basic report for all jurisdictions. This could be supplemented by additional data, if any, required by the respective agencies.

The SAR (see Chart 3) is recommended by the committee for use by all regulatory agencies—federal, state, and local. (The SAR does not include a statement of changes in financial position. Such a statement is generally not required for nonprofit organizations since the information that would normally be presented in this statement is readily apparent in the other financial statements. However, where significant transactions such as financing activities are not otherwise reflected in the statements, the committee recommends that they be disclosed in footnotes or in a separate statement of changes in financial position.)

Advantages of the SAR

This SAR was designed to recognize the fund accounting approach followed by philanthropic organizations and to provide for a proper segregation of unrestricted and restricted funds. At the same time, by providing for the reporting of all funds — both restricted and unrestricted — on a single page, the regulator and potential contributor are shown an overall picture of the financial activities of the organization.

This report also emphasizes the program activities of the organization to show how the organization has utilized its funds for the accomplishment of its stated program objectives.

The basic format in the SAR is similar in many respects to that recommended in the AICPA audit guide for voluntary health and welfare organizations. The formats in the audit guides for colleges and universities and for hospitals are not identical, but the committee believes the SAR is an acceptable regulatory reporting presentation for these entities. The main area where the SAR departs from the format recommended in the three audit guides is the use of a columnar balance sheet. All three guides illustrate a balance sheet in which each fund is reported as a separate balance sheet within a main balance sheet; however, the guides do not mandate the format for financial reporting.

This format is also similar to that being considered by a committee organized by the National Health Council for a publication expected to be reissued in late 1974 containing model legislation and model reporting formats. That publication will be circulated among parties interested in model legislation regulating charitable organizations. It should also be noted that the format of the SAR is very similar to

Chart 3

STANDARD ACCOUNTING REPORT — CHARITABLE ORGANIZATION

FOR YEAR ENDED ____________

FULL OFFICIAL NAME OF ORGANIZATION	REGISTRATION NUMBER
NUMBER AND STREET	CITY AND ZIP

THIS REPORT IS A PUBLIC RECORD, COPIES OF WHICH ARE SENT UPON REQUEST TO ANY INTERESTED PERSON

STATEMENT OF REVENUE, EXPENSES AND CHANGES IN FUND BALANCES

		CURRENT FUNDS		LAND, BUILDING AND EQUIPMENT	DONOR ENDOWMENT	OTHER RESTRICTED*	TOTAL ALL FUNDS
		UNRESTRICTED*	DONOR RESTRICTED				
		(a)	(b)	(c)	(d)	(e)	(f)
SUPPORT, REVENUE, AND OTHER ADDITIONS							
CONTRIBUTIONS							
Received directly from the public	1a						
Allotments from other fund-raising agencies and/or affiliates	1b						
GOVERNMENT GRANTS, CONTRACTS AND FEES	2						
PROGRAM RELATED INCOME							
Patient service revenue	3a						
Student tuitions and fees	3b						
Other	3c						
INVESTMENT INCOME	4						
MEMBERSHIP DUES	5						
OTHER REVENUE (net of related expenses of $)	6						
OTHER (describe)	7						
TOTAL	8						
EXPENSES AND OTHER DEDUCTIONS							
PROGRAM SERVICES	9						
MANAGEMENT AND GENERAL	10						
FUND RAISING	11						
OTHER (describe)	12						
TOTAL — sum of lines 9, 10, 11 and 12	13						
EXCESS (DEFICIT) FOR YEAR — line 8 less line 13	14						
FUND BALANCES AT BEGINNING OF YEAR	15						
TRANSFERS	16						
FUND BALANCES AT END OF YEAR	17						

SEE NOTES TO FINANCIAL STATEMENTS

* INCLUDING ALL BOARD-DESIGNATED FUNDS

STATEMENT OF FUNCTIONAL EXPENSES

ITEM	TOTAL AMOUNT Cols (f)(g)(h)&(i)	PROGRAM SERVICES (DESCRIBE)				TOTAL PROGRAM SERVICES	SUPPORTING SERVICES		OTHER
							MANAGEMENT AND GENERAL	FUND RAISING	(DESCRIBE)
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
1. SALARIES									
2. PAYROLL TAXES									
3. EMPLOYEE BENEFITS									
4. TOTAL SALARIES, PAYROLL TAXES AND EMPLOYEE BENEFITS									
5. AWARDS AND GRANTS									
6. OCCUPANCY									
7.									
8.									
9.									
10.									
11.									
12.									
13.									
14.									
15.									
16.									
17.									
18.									
19. TOTAL BEFORE DEPRECIATION									
20. DEPRECIATION									
21. **TOTAL**									
22. PERCENTAGE OF TOTAL	100 %	%	%	%	%	%	%	%	%

SEE NOTES TO FINANCIAL STATEMENTS.

BALANCE SHEET

ASSETS	CURRENT FUNDS		LAND, BUILD-ING & EQUIP	DONOR ENDOWMENT	OTHER — RESTRICTED	TOTAL ALL FUNDS
	UNRESTRICTED	DONOR RESTRICTED				
	(a)	(b)	(c)	(d)	(e)	(f)
1						
2						
3						
4						
5						
6						
7						
8						
9						
10						
11						
12						
13 TOTAL ASSETS						
LIABILITIES						
14						
15						
16						
17						
18						
19 TOTAL LIABILITIES						
FUND BALANCES						
20						
21						
22						
23						
24						
25 TOTAL FUND BALANCES						
26 TOTAL LIABILITIES & FUND BALANCES						

* INCLUDING ALL BOARD-DESIGNATED FUNDS

SEE NOTES TO FINANCIAL STATEMENTS

NOTES TO FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

that presently required in regulatory reports filed with the States of New York and New Jersey.

Arguments Against the SAR

While few are opposed to the concept of a Standard Accounting Report, many believe that it is unrealistic to expect a number of states and the federal government to adopt uniform reporting. However, as demonstrated by the adoption of the Uniform Gifts to Minors Act and other model legislation, the committee believes that the uniform adoption of the SAR is not an unrealistic goal.

Those who argue against this type of reporting might also point out that there are many different types of organizations involved and that the use of a standard report of this type would result in some force fitting of the organization's activities into line captions which will not be wholly descriptive. There is, however, opportunity for disclosure and flexibility in the SAR when these circumstances occur.

Some may oppose adoption of this report because it follows in many respects the form recommended by one of the audit guides and thus encourages the reporting practices and accounting principles in that guide. Organizations not covered specifically may not wish to be required to follow one of the guides. The committee believes, however, that it is in the interest of all concerned that regulatory reporting follow "generally accepted accounting principles" as defined by the accounting profession rather than have each regulatory body become the accounting rule maker.

Summary

The committee believes that private philanthropy and the public are well served when regulatory agencies assure that the contributing public has timely access to meaningful financial information about philanthropic organizations. In order to provide the best possible communication of financial information and to minimize related administrative costs, the committee recommends the adoption of the Standard Accounting Report as the basic financial statements in regulatory reporting forms.

THE FUND-RAISING PERCENT AS A QUANTITATIVE STANDARD FOR REGULATION OF PUBLIC CHARITIES, WITH PARTICULAR EMPHASIS ON VOLUNTARY HEALTH AND WELFARE ORGANIZATIONS

Arthur Jack Grimes[†]

Introduction

Proposals have been periodically made in the news media and in public legislative hearings that a fund-raising cost percentage (FR%) be used as a standard to measure the worthiness of charitable organizations soliciting public support. The purpose of these proposals is to discourage abuse of public confidence by revealing excessive fund-raising costs to potential contributors.

In an examination of the FR% of tax-exempt organizations soliciting contributions from the public, one finds that this measure varies considerably even among well-run and reputable organizations at any given time and also among the constituent units of such organizations at different times. This paper analyzes the various influences that contribute to and result in such variations. These influences are important to any proposal for use of the FR% as a measure of an agency's effectiveness. The author presents findings and recommendations from this analysis for the Commission on Private Philanthropy and Public Needs to consider in the event that the Commission decides to address the question of the fund-raising ratio as a standard for evaluating public charities.

Study Scope and Design

To reduce variations arising from internal record keeping and accounting, the organizations chosen for this study are (1) charitable organizations in the health and welfare field that are required to report to the solicitations regulatory agency in New York State according to uniform financial accounting and reporting standards, (2) a sample of national voluntary health agencies known to be using the same standards, and (3) national "umbrella" associations (membership federations of charitable organizations in the fields of health, social welfare, museums, foreign service, and higher education). The New York State sample of health and social welfare charities was drawn from a list of charitable organizations registered to solicit funds for such purposes in that state during 1972. The universe for the New York State sample consisted of 2,977 organizations registered with the state's Charities Registration Service (see Table 1). The sample was selected to provide a concentrated coverage of organizations with reported fund-raising costs in excess of 33 percent (see Appendix A for detailed description of the sampling procedure). A total of 20 organizations were selected, 10 from the health field and 10 from the welfare field. An analysis was made of the New York State forms (DDS 497) filed by the sample agencies. Visits were paid to the top staff or volunteer leader when these persons could be located. The leaders of three social welfare agencies in the sample could not be contacted (see note (a) to Table 5). To conserve time for the study, the organizations selected in the New York State sample were confined to those located in the New York City metropolitan area or in Washington, D.C. The sample was confined to the health and social welfare area because this is the field of the author's experience.

The second sample for the study consisted of 19 national voluntary health agency members of the National Health Council (NHC) that report annually to the

---

[†] Director for Public Responsibilities, American Institute of Biological Sciences.

Table 1

Distribution of Reported Fund-Raising Percentages of
New York State Charitable Organization
Registrations, 1972

	Percent*
Total Registrations (2,977)	100
Reporting FR Costs	
none (0%)	50
over 0% to 25%	40
over 25% to 50%	7
over 50% to 75%	2
over 75%	1

*Total fund-raising costs divided by total contributions plus grants.

council that they meet substantially the council's criteria for membership. These criteria include a requirement for annual reporting to the public of activities and accomplishments and financial trusteeship according to uniform standards. Fifteen of the nineteen agencies have issued consolidated financial statements for all levels of operation (national, state, and local) for the fiscal years ending in either 1971 or 1972 according to these standards (see Table 2). These 15 agencies were selected for comparative study with the New York State sample. The NHC health agency members are used for analysis of measures of fund-raising costs and practices and fund

Table 2

National Health Council Member
Voluntary Health Agencies With Consolidated Financial Statements
for All Operational Levels, Fiscal Year Ending 1971 or 1972

American Cancer Society
(8/31/72)

American Heart Association
(6/30/72)

National Easter Seal Society for
Crippled Children and Adults
(8/31/72)

American Lung Association
(3/31/71)

National Foundation (Polio and birth
defects)
(5/31/72)

Muscular Dystrophy Association
of America
(3/31/71)

National Multiple Sclerosis Society
(12/31/71)

National Cystic Fibrosis Research
Foundation
(2/29/72)

Epilepsy Foundation of America
(12/31/72)

National Hemophilia Foundation
(6/30/72)

National Kidney Foundation
(6/30/72)

American Diabetes Association
(12/31/71)

National Association for Prevention
of Blindness
(12/31/72)

American Social Health Association
(V.D., prostitution, etc.)
(12/31/72)

Note: Dates in parentheses represent end of fiscal year.

All of the agencies reporting in accordance with Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations. (National Health Council, National Social Welfare Assembly, 1964).

sources. The author has been familiar with the operations of these organizations over the past 12 years and is well acquainted with their accomplishments, their practices, and their fund-raising problems.

Finally, the author interviewed representatives of the "umbrella" organizations which comprised the third sample. These interviews provided an opportunity to obtain information on fund-raising and management practices, estimates of the range of fund-raising costs for these organizations' respective fields, and a description of major influences on variations in fund-raising costs from the viewpoint of an experienced professional in each specialty field. (See Table 3.)

In addition to findings from this study, influences on fund-raising costs identified in earlier analyses of this subject are incorporated in this report.

I

FINDINGS AND RECOMMENDATIONS

1. The fund-raising cost percentage as a standard can at best provide an approximation of agency efficiency in raising money for a specified time period, but it cannot measure the agency's effectiveness in meeting needs.

Fund-raising cost percentages can be informative and useful as *one* indicator of possible abuse of public support but only after there is a clear understanding of what *is* included and what is *not* included in both the numerator and the denominator of the ratio. In this regard it may not be possible to identify and separately report all of an agency's fund-raising costs, and, in the field today, there is no agreed-upon base for determining fund-raising cost percentages.

2. The ratio of total fund-raising expenses over total income from direct and indirect contributions plus grants provides the fund-raising cost percentage that is most comprehensive and appropriate as an approximation of agency investment in raising money related to the amount actually brought in.

The study sample of national voluntary health agencies for all operational levels shows a fund-raising cost percentage range of 9 percent to 34 percent. The average is 17 percent with a mode of 15 percent. The distribution for these percentages for the 15 NHC member national voluntary health agencies in the study indicate that 9 out of 15 had FR cost ratios of 15 percent or less. All but two had FR cost percentages of less than 22 percent; for all 15, FR percentages were less than 35 percent of the income from total contributions plus grants (see Appendix B).

3. There are causative factors unrelated to abuse or fraud for variations in fund-raising cost percentages among charitable organizations and for the same organization for different time periods.

The reasons for this conclusion include situational influences beyond the agencies' control (for example, length of time in existence, weather conditions during campaign periods, inflation) and management influences reflecting administrative decisions that do not involve dishonesty or lack of desire to serve the public interest (experimentation with new fund-raising techniques, selection of one of several legally acceptable accounting and/or financial reporting practices, choice of methods for communications with the public, some more successful at times than others, and so forth).

4. A small portion (10 percent) of charitable organizations registered for solicitation privileges in the State of New York in 1972 reported fund-raising costs in excess of

Table 3

Administrative Practices in Nonprofit Areas Related to Financial Accounting Standards, Public Reporting Practices, and Usual Range of Fund-Raising Cost Percentages

Types of Charitable Organizations	Generally Issue Financial Reports to Public	Uniform Financial Accounting and Reporting Standards for this Field	Fund-Raising Percent (average and/or range)
Museums	No	No (No standards unique to this field; F.R. not recorded. All support costs classified as "administrative," less salaries.)	No data available. ("Administrative" expenses = 30% of income plus salaries. Salaries not classified in "administrative"; 12% for "other" expenses.)
Voluntary agencies for foreign services	Yes	No (As charities in the health and welfare field, are expected to be on Standards.*)	F.R. costs = approximately 10% of contributions (est.).
Colleges and universities	Yes	Yes (Separate standards for this field.)	Average is 15% to 25% of total contributions.
Social welfare	Yes	Yes (Some national organizations and their affiliated units are on uniform Standards.*)	Average is 15% to 35% of the contributions (est.).
Health	Yes	Yes (Most national organizations and their affiliated units are on uniform Standards.*)	Average is 10% to 35% of total "contributions" (est.).

*Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations (National Health Council, National Social Welfare Assembly, 1964).

25 percent of the total contributions and grants; less than 3 percent reported fund-raising costs in excess of 50 percent and less than 1 percent in excess of 75 percent.

Of the 31 (out of 2,977) organizations reporting FR%s in excess of 75 percent, only 8 had income of $75,000 or more in 1972. Of the 99 agencies reporting FR%s of 50 percent or more, 80 raised $75,000 or less. The organizations reporting fund-raising costs in excess of 50 percent are frequently very small in size; many of these organizations' investments in raising money could very easily have exceeded their return in contributions because of the small amount of money involved in fund-raising activity. This relatively small number of charitable organizations reporting a high FR% is important to keep in mind in developing provisions for regulating charitable solicitations. Excessive reporting requirements aimed at such a minority could seriously affect the majority of organizations in this field and their resources for program services to the public by increasing costs for management and fund raising. (Of the 2,977 agencies registered to solicit contributions in 1972 in New York State, 1,475, or 50 percent, reported *no* fund-raising costs. From the data available, it appears that a large number are small local groups operating with donated time and materials and continuing to receive funds from regular contributors without follow-up solicitations. It is apparent that some of the organizations reporting 0% fund-raising costs are not following the recommended uniform standards of financial reporting for organizations of their type. The most commonly observed practice not consistent with the reporting standards for this field is the subtraction of all fund-raising expenses before reporting of income.)

5. The study sample of local voluntary health and welfare agencies soliciting contributions in New York in 1972 (sample was weighted with those with higher than average reported fund-raising cost ratios) indicates that 4 out of 20 (20 percent) made gross errors in the fund-raising cost percentages they reported.

From the interviews with the sample agencies it is reasonable to suspect that many inaccuracies occurred from a lack of awareness of the types of expense allocations that are appropriate to reflect fund-raising expenses. Estimates are given in this report for corrections in the reported fund-raising cost percentages for the sample agencies. It would not be possible, without auditing the financial records, to determine in most cases whether or not fund-raising costs reported to the State of New York are correctly calculated. Only in the more obvious situations are estimates made for corrections, that is, where there is no F.R. percentage reported and actually there are expenses for fund raising or where fund-raising costs were incorrect and accurate costs not precisely known.

6. The fund-raising cost percentages for national voluntary health agencies do not appear to have a relationship to the total income raised by the organization or to the relative rank of the disease or disability for which they are appealing among causes of death and disability.

7. Methods of soliciting the public for contributions is a prime influence on the efficiency of the organization's fund-raising process. Direct, in-person solicitations are used most frequently (two of top three fund-raising methods by volume of income) by organizations with the lowest cost associated with raising money. Organizations depending primarily on mail solicitation for the bulk of their income are those with the higher fund-raising cost ratios to total contributions plus grants.

For the national voluntary health agencies in this study, a combination of in-person solicitations and participation in federated campaigns is associated with low fund-raising cost percentages. There are exceptions to this, but where the exceptions occur, there are usually special circumstances that reduce the cost of raising money. In addition, total fund-raising costs to an agency for participation in federated fund-raising may be incomplete and understated, although not deliberately.

8. The foregoing findings suggest that caution be exercised in comparative evaluations of public charities' fund-raising costs, in attempts to devise standard methods of calculating fund-raising cost percentages or in efforts to set ceilings for them irrespective of the individual organization's circumstances.

In general, the study experience revealed the existence of so many factors and so many variations in objectives, procedures, and interpretation that the proposed comprehensive analysis of the New York sample was not possible for accomplishment of the study's initial objective in the time allotted. The more revealing sample of national voluntary health agencies confirmed the existence of all these organizational and administrative variants even among a group of the more advanced public charities. The Commission on Private Philanthropy and Public Needs should address the subject of fund-raising cost percentages with great care in light of the current state of reporting practices, bookkeeping methods, the great range of informal variations revealed by the very limited scope of this study, and the fact that no other similar studies in adequate depth or breadth have been conducted.

Conclusions

It is apparent from this survey and analysis that fund-raising percentage costs can be "high" for valid reasons. Consequently, an arbitrary ceiling should provide for exceptions for reasons that recognize the possible impact of an organization's circumstances or method of solicitation. There are obvious abuses in the charitable solicitation field and a consistently "high" FR cost ratio for three to four years is a valuable but *limited* index to possible exploitation of public support. A 50 percent FR cost for an agency with an especially unpopular cause or for one that is just starting out in raising money from the public could be reasonable. For an organization with a relatively popular cause and an established constituency, this same FR percentage gives more grounds for question if it persists beyond a single, possibly unusual, year.

Some states have passed laws setting an arbitrary FR cost percentage beyond which a charitable organization's fund-raising costs may not go. By recognizing no exception, this percentage is the only measure of legitimacy to solicit funds in that state the next year. There is concern by those who are familiar with the public charitable field that such arbitrary legislation will weaken or destroy the field in the process of trying to improve it.

Setting an arbitrary percentage of income or expenses for fund-raising costs without provision for flexibility in individual agency circumstances can have the following effects: (1) discourage desirable charitable efforts in the early organizing and operating stages, when costs are inevitably higher; (2) tempt agencies to falsify their figures to conform to the pre-set percentage allowed by the legislation; and (3) add to the cost for agencies that now employ outside fund-raising assistance at less than the pre-set percent by setting a permissible higher amount that is government approved.

The overwhelming majority of voluntary agencies, national, state or local, whether they seek financial support from the public through combined campaigns or individual campaigns, recognize the responsibility of government to enact appropriate legislation that protects the charitable instincts of citizens from exploitation and abuse and to enforce such legislation wisely and impartially. Legislative bodies and public agency administrators must recognize that voluntary organizations need to spend money (that is, they need to incur non-program service costs) to pursue their objectives. These organizations, as is true for government and for private business, cannot function without money for administrative costs, including budget planning and presentation to funding sources to raise money for program services.

Voluntary health and welfare agencies have established a record of working towards disclosing, in the public interest, their operations and their costs for providing services. Increased recognition needs to be given to the growing practice of full financial disclosure by voluntary health and welfare agencies according to uniform standards of accounting and reporting. Where possible, the cost ratios of these agencies need comparison with the "supporting service" costs of commercial or for-profit corporations and also of government for provision of similar services. From the data presented here and in reports of the costs for overhead or the costs for conducting business we may find from such disclosure and comparisons that the private charitable agencies are above average in cost efficiency as well as in their effectiveness.

II

MEASURING PRODUCTIVITY BY A FUND-RAISING PERCENTAGE

Perspective

Some of the serious obstacles to formulation of a universally applicable method of calculating fund-raising cost ratios (and, therefore, to prescribing a proper fund-raising cost percentage) are the following:

- It may not be possible to identify and separately report all of an agency's fund-raising costs. Since some of the activities undertaken by many voluntary health and welfare organizations necessarily and simultaneously serve the program objectives and supportive services (management and fund raising) to carry on other functions, it is not possible, even with the most meticulous accounting, to completely isolate and precisely report all of an agency's expenditures for any single function. This is true for fund raising, "management and general," or a particular program service.

- Many agencies receive support indirectly through federated and other fund-raising organizations in addition to direct support from the public. The recipient agency may not be able to determine the fund-raising cost attributable to this support.

- Bequests or support from grants may be received years after they were solicited, or be unsolicited. This lapse of time may preclude any meaningful matching of this support and revenue with the fund-raising costs.

- Only relatively large agencies can be expected to have accounting systems and staffs that will permit full separate accounting for costs of multiple fund-raising activities during a given year – for example, operating fund campaigns, building fund campaigns, special fund-raising events.

- There is not common agreement in the field as to the base to be used for computing a ratio. There is, also, lack of uniformity as to what is includable as "fund-raising" expenses. Sometimes included are costs for other purposes such as "management and general."

Expenses in the "management and general" category are not identifiable to a specific program. The category includes essential operations to assure appropriate and effective programs, such as, board meetings, training and orientation sessions on total agency functions, proper record-keeping efforts to evaluate effectiveness towards achieving agency goals. The "management and general" category is necessary for operating any nonprofit organization. This type of expense, however, is as much if not more significantly related to the planning, management and evaluation of service functions of the agency as it is to fund raising.

To help in making comparisons among organizations, by agencies themselves in judging their relative efficiency and by potential donors concerned with measurement of productivity, voluntary organizations have voluntarily taken steps to help increase the validity of such comparisons. Uniform systems of accounting and public financial reporting have been developed by different segments of the charitable field, such as hospitals, colleges and universities, and voluntary health and social welfare organizations. One example is the development and adoption of *Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations*, published in 1964 by the National Health Council (for the majority of the national voluntary health agencies) and the National Social Welfare Assembly, now the National Assembly of National Voluntary Health and Social Welfare Organizations (on behalf of major social welfare organizations).

In the *Standards* sources of income are identified within two basic categories—income received directly and income received indirectly. Within these two categories funds are grouped into types of income. Rules are provided for what types of income the categories are to include. Expenditures are classified in two major divisions: "program services" (includes research, patient services, public education, professional education, community services) and "supporting services" (management and general administration and fund raising). The accrual basis for accounting is used. The rationale behind the selection of accrual-basis accounting is that cash-basis accounting for financial reporting purposes could permit the arbitrary shifting of income and expenses between financial report periods, which could result in financial statements that are misleading as to financial position and results of operations.

In 1974 the American Institute of Certified Public Accountants (AICPA), working with the *Standards'* sponsors and others, revised their *Audit Guide for Voluntary Health and Welfare Organizations* (1963), adopted the major principles of the *Standards* (there are some differences, but these are mainly in terminology and depreciation accounting) as the *only* acceptable financial accounting and reporting base upon which audits of agencies in this field are to be conducted after 1974. As a result, a new edition of the agency-endorsed and sponsored *Standards* is being prepared to bring the AICPA new *Audit Guide* and the *Standards* into full conformity. It will be published in 1975 under the sponsorship of the three major umbrella groups in the health and welfare field, the National Health Council, the National Assembly of National Voluntary Health and Social Welfare Organizations, and the United Way of America. Beginning with fiscal years ending in 1975, in order to obtain an unqualified CPA audit opinion, all voluntary health and welfare organizations at every level of operation will be expected to use the principles of the new AICPA *Audit Guide* and the uniform accounting *Standards*. Obviously, this is a major development for improved accountability.

When dependence is placed on fund-raising "efficiency" as the only or major index to worthiness of a charitable effort, certain influencing factors are significant. The original plan for this study envisioned application of these factors to the sample of organizations reporting to New York State with fund-raising percentages either at 0 percent or in excess of 33 percent. Time limitations made it obvious that a fully satisfactory analysis in these terms would be too complex and detailed. Accordingly, the New York sample was supplemented with the sample of 15 national voluntary health agencies for which data were available that could be analyzed in terms of the range of factors considered as affecting fund-raising success.

The diversity of factors affecting fund-raising success and its cost efficiency are grouped into four categories for purposes of this study.

Technical Influences

What is Classified as Fund-Raising Expenses

In type and scope, fund-raising efforts of voluntary agencies range from nationwide appeals employing virtually all the techniques of major product advertising campaigns to one or two appearances before budget committees of the federated fund-raising organizations that have assumed the fund-raising responsibility. What is classified as fund-raising expenses also includes the expenses in applying for grants from either private or public sources. All voluntary health and welfare agencies adhering to the *Standards* are expected to use the following definition in classifying expenses as fund raising: "Expenses of all activities that constitute or are an integral and inseparable part of an appeal for financial support."

This definition represents activities conducted or materials distributed and used for the sole or principal purpose of getting the public to financially support the agency's cause plus all other expenses incurred in planning, directing, administering, or participating in fund drives or other programs in which contributions are actively solicited. The definition and processes for identifying what is to be classified as "fund raising," based on the uniform *Standards,* is accepted by the accounting professional as well as agencies in the health and welfare field. All costs associated with fund-raising activities, as recognized in the definition, are to be included in the numerator for determining the fund-raising cost percentage.

An Appropriate Base for Comparing Fund-Raising Cost Percentage

In the initial stages of preparing for this paper, it became apparent that the identification and selection of the base that most accurately and comprehensively reflects the costs for raising money would be a significant technical influence on fund-raising cost percentages. A number of different ratios in current use were analyzed for the study. (The details of this analysis appear in Appendix B.)

None of these ratios are perfect measures of the return on fund-raising effort invested. Considering the input for each base in the five cost ratios analyzed, total contributions plus grants reflects, in my opinion, the most comprehensive total dollar returns on agency fund-raising efforts. For this reason, this particular ratio is used in computing the FR cost percentages in this study for the National Voluntary Health Agency sample and is used by the Charities Registration Bureau of the State of New York in presenting the cost ratios for the sample of agencies selected from that source.

Situation Influences

The more common "situation" influences (that is, factors or events normally beyond control of the agency in a particular locality) on fund-raising costs are listed below. No attempt has been made to list these factors in the order of their importance.

The Age of the Agencies

New agencies, when first established and for several years thereafter, have higher fund-raising costs than the older, better-established agencies. It takes time and organizational talent to build a constituency even for the most worthwhile and appealing causes. Normally, after a three- to five-year period campaign costs become relatively smaller in relation to increased income.

Geographical or Population Differences in Costs

In some sections of the country expenses of fund raising are less than in others. This is more likely to be so in the less urbanized states. Most fund-raising personnel agree that costs are notably higher in cities of 100,000 or more population.

Severe Weather or Community Emergencies

Some agencies rely upon a single predetermined day or week for the raising of a major portion of their income. A period of bad weather could be damaging and affect cost.

Increasing Costs of Doing Business

Voluntary agencies are subject to the inflationary pressures. Salaries and wages cannot remain static, the cost of necessary materials increases, postal rates go up. Although some donors may respond with larger gifts to help take up some of the gap, the rate of response is likely to be slower with a resultant net increase in expenses.

Bequest Giving

It is difficult to attribute a fund-raising cost to this kind of income. And yet, as an important source of income included in financial reports, it can exert significant influence on the FR cost percentage.

Management Influences

Two types of management activities are identified as essential for the fund-raising process: Fund solicitation methods and administrative practices. Analysis of these factors and their relation to the fund-raising percent in the sample of test agencies is presented in this study.

Fund Solicitation Methods

Key differences in fund-raising methods are whether solicitations are made: (1) in-person (solicitation by personal appearance, such as neighbor calling on neighbors house-to-house, personal visits to businesses, foundations, government departments); (2) indirectly (requests for contributions that are not made in person such as by mail, telephone, telethon); or (3) benefit-gift arrangement (solicitation for a donation made by offering something of value or direct benefit to the donor, part of the proceeds of which are expected to go to the charitable organization, for example, sales by a charitable organization of tickets to a theater party, sale of a piece of merchandise, or a service such as a car wash or a subscription to the agency's publication, part or all of the price of which is declared as a contribution to the charitable organization's purposes).

Tables 4,5, and 6 include a tabulation of the effect of fund solicitation methods on the sample of health and welfare agencies registered with the State of New York (Tables 4, 5) and the sample of national voluntary health agencies (Table 6). As presented in these tables, the FR cost ratio used is the relationship of total fund-raising cost to total contributions (direct and indirect) plus grants. For the New York State agencies, the fund-raising cost ratio is based upon the financial report of *one level* of operation, (national, state, or local). The data on the national voluntary health agencies is based upon the consolidated financial report for *all levels* of operation, national, state, and local. Most of the organizations use a diversity of fund-raising methods. The top three fund-raising methods bringing in the most income for each agency have been determined. Other fund-raising methods used by the agency influence the amount of money raised and the cost of fund raising, but to a lesser degree.

The data presented on the 20 organizations in the New York State sample show the following about methods of solicitations in relationship to fund-raising costs:

- Those using direct (in-person) solicitation tend to have lower fund-raising costs.
- Those using indirect solicitation techniques are those with the higher fund-raising costs.
- Those using the benefit-gift approach have costs in the mid-range between that for the above two types of fund-raising processes.
- Fund-raising costs ratios do not have a relationship to the relative number of cases or the disablement severity associated in the public's perception of the agency's cause.

For the national voluntary health agencies sample, Table 6 confirms similar findings to those of the New York State group:

- The lowest fund-raising cost ratios (17 percent or less) are for agencies whose prime fund solicitation methods are in-person appeals (including bequests, which most professionals consider result primarily from personal contacts with the agency over the years) or personal solicitation together with participation in federated campaigns. This is true for 9 of the 11 organizations with the lowest fund-raising percentages. (The two exceptions to this observation are the American Diabetes Association and the National Easter Seal Society for Crippled Children and Adults. In a review of their respective fund-raising methods, ADA reports that it raised its greatest amount of income in 1972 from sales of subscriptions for its publications (primarily to practitioner specialists in this field) and from diabetic camper fees, combined with returns from federated campaigns. The ADA, founded in 1940, has only recently (1970) converted from a primarily professional membership association for specialists in diabetes to a voluntary health agency. It has yet to have its first nationwide mass media fund-raising campaign. The Easter Seal Society variation from the normal fund-raising practices for the same cost ratio is that its second largest source of money is government grants (in-person appeal) and fees which usually incur minor fund-raising expenses. (Its major source of income is the Easter Seal mail campaign, an indirect campaign technique.) The above income sources plus the high appeal of crippled children and adults for voluntary contributions is thought likely to help reduce their cost for fund-raising to the range that is common for those using the direct, in-person appeals.)

- Those four national voluntary health agencies with costs above 19 percent rely on mail solicitation or telethon as their prime fund-raising methods (National Foundation, Muscular Dystrophy Associations of America, American Lung Association, and Epilepsy Foundation of America). Each of these organizations has a diversified fund-raising campaign with personal solicitation included as one method among the top techniques for obtaining income.

Table 6

New York State Sample of Health Agencies, Ranking by Selected Influences on Fund-Raising Success

Agency Cause	1973 FR %	Public Awareness: Area Prevalence Hi	Med	Low	Area Exposure Hi	Med	(Comm) (Media) Low	Public Acceptance: Number Leadership Hi	Med	Low	Number Volunteers Hi	Med	Low	FR Method (1 or 2 of top 3): In Person	Benefit Gift	Indirect	Admin. Practices: CCV or PFR	Paid Staff	Stds. Acctg	Pub. Fin. Rep.	Comp.	Relative Rank: Income	Deaths	Disability	Focus: Local	Natl.	Foreign or Intl.
Aging	6%*	x			x					x	x			x				x				5	1	1		x	
Cerebral Palsy	0*			x		x			x			x			x							6	6	6	x		
Degen. Disease	3			x			x			x			x			x					(b)	3	4	6		x	
Vol. Sterilization	10						x		x			x		x				x	x	x		9	-	7			x (b)
Cancer Cytology	22	x			x					x			x			x		x			(b)	5	2 (c)	4 (c)			
Learning Disabil.	45		x			x			x		x				x			x		x		7	-	3	x		
Rheum. Fever	46		x			x				x			x		x			x		x		1	8	3	x		
Mult. Scl.	10 ***			x			x			x			x		x				x	x (a)		10	5	7	x		
Cancer Care	42	x				x			x		x				x				x	x (a)		6	2 (c)	4 (c)	x		
Crip. Child	166 **	x			x			x			x				x			x	x	x		4	-	5	x		

(a) Agency's operations are part of area organization report.

(b) Information was not available from agency, only through legal counsel of agency.

(c) Given comparable ratings - same disease concern.

* FR cost ratio based on incorrectly reported figures by agency to N.Y. State. Estimate range for aging is 5% to 10%; CP is 10% to 25%.

** FR cost ratio affected by unique FR experiment that failed (special event). Normal range is 35% for this agency for prior and subsequent year.

*** Final year of operation. Disbanded by national as chapter because of lack of FR and program productivity.

$$FR\% = \frac{\text{Total fund-raising expenses}}{\text{Total contributions plus grants}}$$

Table 5

New York State Sample of Welfare Agencies, Ranking by Selected Influences on Fund-Raising Success

Agency Cause	1972 FR %	Public Awareness						Public Acceptance						FR Method (1 or 2 of top 3)			Admin. Practices					Relative Rank		Focus		
		Area Prevalence Hi	Area Prevalence Med	Area Prevalence Low	Area Exposure Hi	Area Exposure Med	(Cause) (Media) Low	Number Leadership Hi	Number Leadership Med	Number Leadership Low	Number Volunteers Hi	Number Volunteers Med	Number Volunteers Low	In Person	Benefit Gifts	Indirect	CCV or PFR	Paid Staff	Stds. Acctg	Pub. Fin. Rep.	Comp.	Income	Death or Donat.	Local	Natl.	Foreign or Intl.
Court Case Counsel.	0%		x			x			x			x		x				x				6	-	x		
Equal Opportunity	0	x			x					x		x		x				x				5	-	x		
Intl. Immigrants	2			x		x				x		x		x				x				1	-			x (Int)
Community Center	6	x			x			x				x		x				x		x		3	-	x		
Dogs for Blind	20			x	x					x			x			x		x	x	x		2	-		x	
Israel Orphans	41			x			x			x			x			x		x				7	-			x (F)
Athletics for Blind	50			x		x				x			x			x	x				x (a)	10	-	x		
Minority Health Prof.	55			x		x				x			x		x			x				9	-	x		
Children Camping	61	x				x				x			x			x	x				x (a)	8	-	x		
Education for Children	200*	x				x				x			x		x			x			x (a)	4	-		x	

(a) These agencies could not be interviewed or contacted for information. One national was contacted and information on operations and financial report "not available to outsiders."

* FR cost ratio is based on incomplete financial data supplied to N.Y. State. Estimate range 5% - 10% from similar type organizations.

** CCV - Commercial Co-venturer used, based on data available.

$$FR\% = \frac{\text{Total fund-raising expenses}}{\text{Total contributions plus grants}}$$

NOTES TO TABLES 4 AND 5

Criteria

For Ranking Agencies by Selected Influences on Fund-Raising
New York State Voluntary Health and Welfare Agencies
(CPPPN Study Sample)

Need Awareness	Hi	Med	Low
Prevalence			
Welfare - Estimate of proportion of area population experiencing the problems compared to state/national averages	1	2	3
Health - Rank on list of causes of deaths or disabilities for New York State sample ([illegible] organizations)	1-3	4-7	8-10
Exposure			
*Case - Visibility of the disability in individuals	visible	to	non-visible
*Media - Appearance in media coverage	regularly year round	sporadic year round	none or little except campaign time
Need/Organization Acceptance			
Campaign Leadership			
Based on relative numbers of persons on fund-raising campaign committees, board from the following fields:			
Entertainment Business Politics Professionals (field) Others (especially social elite)	5 fields	3-4 fields	2 or less fields
Volunteers (Est.)**			
number - local level operation	100 +	50-100	less than 50

*Ranking based on combinations of these two as follows: If patients' disability is visible and media exposure by (author's observation) is high or medium, the ranking is high. If disability is visible but low media exposure, ranking is medium. If disability is not usually apparent then media exposure ranking determines the ranking.

**Based on estimates from agency representatives and/or available materials on the agency.

- It is also apparent from examination of the data in Table 6, Col. 1, and the income data for these agencies in Table B-1, Appendix B, that the FR cost percentages are not related to the relative rank among the various causes of death and disability represented (Table 6, Cols. 13 and 14) or to the total income raised by each of the organizations (Table B-1).

Administrative Practices

Administrative decisions determine whether or not the agency employs professional staff members for fund raising or engages an independent resource for this purpose. Some organizations employ professional fund-raising counsel to assist in planning special campaign strategies or for periodically revitalizing overall solicitation efforts. Unqualified persons can exploit organizations unfamiliar with

Table 6

National Health Council National Voluntary Health Agencies, Ranking of Agencies by Selected Influences on Fund-Raising Success

National Voluntary Health Agencies	(1) 1972 FR%	Public Awareness						Public Acceptance						Fund-Raising Methods (1 or 2 of top 3)			Administrative			High to Low Rank		
		(2) Prevalence			(3) Disability and Media Exposure			(4) # Top Campaign Leadership			(5) Number Volunteers			(6) In Person	(7) Benefit Gifts	(8) Indirect	(9) Paid Staff	(10) Stds Actg	(11) Pub. Rept.	(12) Contr. and Grants	(13) Death	(14) Disab.
		Hi	Med	Low	Hi	Med	Low	Hi	Med	Low	Hi	Med	Low									
Social Health	9%	x				x				x			x			x	x	x	x	15	11	5
Kidney	10		x			x			x				x	x			x	x	x	11	6	9
Cancer	12	x			x			x			x			x			x	x	x	1	2	8
Heart	14	x			x			x			x			x			x	x	x	2	1	1
Hemophilia	14			x			x		x				x	x			x	x	x	12	10	13
Diabetes	14	x				x			x				x		x		x	x	x	14	5	4
Blindness	14	x			x				x				x	x			x	x	x	13	--	3
Crippled ch. & Adults	15	x			x			x			x					x	x	x	x	3	--	2
Arthritis	15	x			x				x			x		x			x	x	x	7	--	3
Multi. Scl.	17			x			x		x			x		x			x	x	x	8	7	10
Cyst. Fib.	17			x			x		x			x		x			x	x	x	9	9	12
Birth Defects	19	x			x						x					x	x	x	x	5	4	2
Musc. Dyst.	21			x		x					x					x	x	x	x	6	8	11
Lung	27	x				x				x			x			x	x	x	x	4	3	6
Epilepsy	34		x				x			x			x			x	x	x	x	10	--	7

$$FR\% = \frac{\text{Fund-raising expenses}}{\text{Total income from direct and indirect contributions plus grants}}$$

NOTES TO TABLE 6

Criteria

For Ranking of Agencies by Selected Influences on Fund-Raising
National Health Council Voluntary Health Agencies
(CPPPN Study Sample)

Need Awareness

Prevalence

	Hi	Med	Low
Rank on list of causes of deaths or disabilities	1-5	6-10	11-15
Disability exposure*	visible	to	not visible
Media exposure*			
T.V., newspapers, radio	mention about daily year round	sporadic year round	little/none except campaign

*Ranking based on combinations of these two as follows: If patients' disability is visible and media exposure by (author's observation) is high or medium, the ranking is high. If disability visible but low media exposure, ranking is medium. If disability is not usually apparent then media exposure ranking determines the ranking.

Need/Organization Acceptance

Top campaign leadership based on relative numbers of well-known names with organization connections from the following areas listed in national campaign materials:

Entertainment/media
Business
Politics/law
Science/medicine
Others (especially social elite)

Volunteers**

National	over 1,000,000	over 500,000 up to 1,000,000	less than 500,000

**Numbers of volunteers based on estimates reported to National Health Council via annual NHC eligibility affirmation materials in 1972 and 1973.

appropriate fund-raising practices. Reputable professionals in the field have a code of ethics, one of the provisions of which is to charge an appropriate fee, agreed upon in advance, for the services to be rendered. (See American Association of Fund-Raising Counsel, Inc., *Giving USA*.) The term "commercial co-venturer" (CCV) is used in this report to refer to individuals in the fund-raising field agreeing to arrangements that are dependent on a percent of funds raised or similar graduated fees from the results of the campaign.

"Administrative practices" is a management influence that also includes practices followed in accounting for both program and financial trusteeship.

In Tables 4 and 5 the data under "administative" practices include references to specific problems encountered in obtaining information from the agencies in this study that should be readily available to the public upon request (such as financial reports, program descriptions, fund-raising practices). Illustrative of agencies in the New York State sample following "full disclosure" administrative practices are those with fund-raising costs above the mid-range. These agencies are issuing to the public financial reports according to the *Standards*. It is important to note that two of the three New York State sample health agencies with fund-raising costs above 50 percent consolidate their figures in an area organization report, and thus the impact of the local cost is not apparent. The third health agency in this category issues a separate annual report, but its fund-raising costs are in practice usually in the mid-range.

Administrative Practices in Other Voluntary Fields

Table 3 presents the status of the administrative practices measured in this study in relation to their effect on fund-raising costs for nonprofit organizations in five national special interest areas, including health and social welfare. These data are based on discussions with representatives in each of the fields identified in the table: museums, colleges and universities, national social welfare organizations and health organizations, and voluntary agencies with foreign activities.

Museums have no standards of financial accounting and reporting unique to their type of operation. The organizations are audited by usual auditing standards for business groups or for nonprofit agencies. It is my understanding that it is only in recent years that standards for operation and organization were established and that these are being implemented by the American Association of Museums. No data are available on fund-raising cost efficiency for museums. From the data that are available in AAM publications, "administrative expenses" are reported at 30 percent but these "do not include salaries." (An additional 12 percent is classified as "other.")

Colleges and universities have uniform financial reporting systems, make annual reports to the public of their financial and program trusteeship, and have fund-raising cost ratios averaging in the range of 15 to 25 percent of the charitable gifts.

The *voluntary agencies with foreign service programs* do not have a uniform financial reporting system implemented throughout the field. Most issue annual reports to the public. Fund-raising costs are reportedly in the range of approximately 10 percent of contributions. It is felt that this comparatively lower fund-raising cost ratio is due to the heavy concentration of agencies in the foreign service field sponsored by religious groups. (Data from Thiessen study, 1968 (see references, Appendix C), which indicates that religious giving incentives (and givers) are different from those for non-religious charitable causes.) One reason that higher fund-raising expenses are not incurred is the prevalence of in-person solicitation in the religious field. The FR percentage costs figure may also be the result of "pooling" FR costs with other types of world service activities for a particular operation (church service, evangelism, and so forth) to which the incentives for giving are much more personal and directed at a "membership" core. It is also likely that the fund-raising costs in such "combination" solicitations are reported as program costs. There are a few professional fund raisers on the staff of voluntary agencies serving in the foreign service field. Reportedly, one of the strongest needs for this area of voluntary action is an increase in the number of professionally trained people.

"Social welfare" is listed as a group of organizations in Table 3 to provide an overview from a national perspective and may be compared with the data on fund-raising costs and financial reporting practices in the study sample of New York State local organizations in the welfare field. An entry is made similarly for national "health" organizations. As indicated on Table 3, many national organizations in the social welfare and health fields are on uniform *Standards* reporting systems and generally issue annual reports of their trusteeship to the public. Data are not available on fund-raising costs for the social welfare field as a whole. Informed "guesstimates" are that the average is in the range of 15 to 35 percent.

Identity Influences

Public Awareness

Public awareness (Tables 4,5, and 6, Col. 2) is defined for this study as the extent of general knowledge of the existence of a particular health or welfare problem and its impact on either large numbers of people in a minor way or fewer people in a major way. Two indices were chosen for measuring this influence on fund-raising ratios: (1) prevalence of the problem, that is, the number of cases or deaths at one point or period in time; (2) visibility of the problem, that is, the overt physical evidence of the disease or affliction, the amount of media coverage of the problem, the effects of the problem and/or the organization soliciting funds to combat it.

For the New York sample, data in Tables 4 and 5 together indicate that those agencies with lower fund-raising percentages tend to have somewhat higher ratings for prevalence of the problem, high visibility of the problem, or high media exposure. However, the *single-year* experience of the Crippled Children and Adults and of Cancer Care reveals that high prevalence and reasonably good media exposure is no assurance of low fund-raising cost percentages. (Taken only one year at a time, as is done in these tables, fund-raising cost ratios can be deceiving. In preparing this material, I reviewed three years' reports for each agency, even though only one year's experience is used in the table. The county-level crippled children and adults agency indicated a cost ratio of 166 percent in 1972. This resulted from a heavy loss on a special event that was a trial experiment in raising money. For the years immediately before and after (1971 and 1973), the average fund-raising cost was 33 percent. For the agency concerned with cancer care, there was a consistently reported percentage in the 50-60 percent range. Prime FR method is benefit-gifts and heavy support from mail campaigns.)

For the national health agencies sample (Table 6) there is a heavier concentration of agencies with fund-raising costs in the lower percentages (less than 15 percent) where there is shown a higher prevalence and visibility of the problem or high or average media exposure of the problem or the organization concerned with it. The National Hemophilia Foundation is an exception to this. There are also two agencies, National Foundation (polio and birth defects) and American Lung Association (tuberculosis and respiratory system diseases) which have fund-raising cost ratios above 19 percent and ratings of high prevalence and high or medium visibility. It should be noted that both of these use mail solicitation as their prime fund-raising method.

Public Acceptance

"Public acceptance," as an influence on fund-raising cost, is public responsiveness to the health problem in terms of sympathy and action. Two measures are appropriate: (1) number of top leadership associated with an organization's fund-raising campaign, expecially from significant influence groups such as entertainment, business, politics, and relevant professions such as science or medicine in the case of health agencies and social work in the case of the welfare organizations; (2) number of volunteers the organization has been able to attract to serve its purposes in any way. (The criteria and sources of information used in defining these measure for "public acceptance" as they relate to the resulting FR%s are provided in the notes to Tables 4, 5, and 6.)

With adjustments in the sequence of the listing of sample organizations by fund-raising cost percentages to correct for obvious errors in reported fund-raising costs, the data presented in Tables 4 and 5 show that in terms of the influence of "public acceptance" on the FR percentage, the organizations with lower fund-raising cost ratios are those with more campaign leadership from the opinion-maker fields and a larger number of volunteer workers. The sensitivity of the "public acceptance" measures of influence on fund-raising cost can be seen for the national health agency sample in Table 6 by the relatively low number of top campaign leaders and volunteers for the agency concerned with venereal disease, prostitution, and drug addiction (social health). There is considerable social rejection of persons with these diseases or problems. For national voluntary health organizations with fund-raising cost ratios in excess of 25 percent there are relatively fewer fund-raising campaign leaders from a variety of influence groups and, based on reports from these agencies, relatively fewer volunteers. (The Epilepsy organization reports that there is a social stigma attached to the people with this problem. Leaders in the organization feel that this affects the willingness of persons to identify with the cause by publicly soliciting funds for its work. Data supplied by the American Lung Association indicate less diversity of campaign leadership from significant influence groups and fewer volunteers than for those organizations in the sample with lower FR%.)

III

OVERVIEW

Determining how effective or "worthwhile" voluntary organizations are to community or national goals requires consideration of what is to be measured and, subsequently, the varying factors that must be taken into account in making such a measurement. This study has considered in dollar terms the relative efficiency in use of funds as measured by the proportion expended for fund-raising purposes by certain types of charitable organizations. If the question of how effective or worthwhile these agencies are to the communities they serve is put in terms of dollar cost efficiency in producing end products of knowledge, services delivered and material produced for the money invested, compared with alternative ways of organizing or administering resources to reach the same end, as is done here, then the results and their significance can be quite different than they would be if the *intrinsic* value of the process used by the agencies is added to what is to be measured. Examples of such benefits provided by many of the charitable organizations such as those considered in this study are citizen involvement, leadership development, and increased public awareness and activity in solving problems.

Measurement of the broader spread of intrinsic benefits was beyond the scope of this study, but such evaluation effort needs to be encouraged to provide insight into the relative benefits of the existing structure as well as possible improvement in ways of providing services to individuals in the community.

Short of a broader spectrum for measuring worthiness or value of the private charitable organizations' productivity, research to provide cost-benefit comparison with the overhead or with the cost for conducting business by government and commercial organizations in the same or related fields would be helpful in determining relative efficiency.

Appendix A

Sample of Health and Welfare Organizations Registered in New York State

The sample, developed in consultation with Professor Nicholaus Tideman, was selected to provide concentrated coverage of organizations with high fund-raising costs. The universe used was the listing by industry code of New York State registered charitable organizations in 1972 in the order of their ratios of fund-raising costs to total contributions prepared by Malvern J. Gross, Jr., of Price Waterhouse, Inc. The procedural rule was to take every fifth organization in health and welfare, starting with the first on the list, until five of each type had been selected. The next organization in each field was selected five pages (50 organizations) later, and then four more organizations were selected at 10 page intervals. Thus, 20 organizations were selected in all, 10 from each industry. The highly sampled high-cost organizations all had fund-raising costs in excess of 40 percent of contributions. Each industry then provided three organizations with reported costs of zero. In two cases, Washington, D.C. organizations were selected. In several cases organizations outside the greater New York area came up and were replaced by the next organizations in the list to reduce travel requirements. The list of organizations is as follows:

HEALTH

Req. #	Name	FR %
40352	Nassau Society for Crippled Children & Adults	166
43095	Cancer Care, Inc. – Whitestone Chapter	62
43116	Society – Richmond Co. Chapter National Multiple Sclerosis	53
07887	Irvington House	46
41671	Nassau Association for Children with Learning Disabilities	41
08829	Association for Voluntary Sterilization	10
08400	National Cancer Cytology Center	22
12316	Indep. Citizens Research Found. for Degenerative Disease	3
08445	Gotham Cerebral Palsy League	0
42303	Gerontological Society	0

SOCIAL WELFARE

Req. #	Name	FR %
40358	National Association for the Education of Youth	300
41729	American Legion Childrens Camp of Kings County	61
43068	Queens Clinical Society of New York	55
12566	Athletics for the Blind	20
09627	Orphan Hospital Ward of Israel	41
08951	Guiding Eyes for the Blind	20
40341	Goddard Riverside Comm. Center	8
07638	Tolstoy Foundation	2
42868	Co-ordinating Council of Long Beach	0
41475	Home Advisory Service Council of New York	0

Appendix B

Choice of a Base for Comparing Fund-Raising Cost Percentages

Table B-1, cols. 2-6, provides an analysis of fund-raising cost percentages using five frequently used bases for compiling the fund-raising percentage. The figures in this table are for 15 of the NHC national voluntary health agencies issuing combined financial reports for all levels of operation in 1972 (or 1971).

Column (2) - Total Income

The percentage in column 2 equals

$$\frac{\text{total fund-raising cost}}{\text{total income}} \quad (\text{average} = 16\%)$$

Table B-1

National Health Council National Voluntary Health Agencies Consolidated National and Affiliate Offices, Five Fund-Raising Cost Percentages

Agency (fiscal year ending)	(1) Reported Fund-Raising Costs	(2) Total Income Amount	FR%	(3) Total Expenses Amount	FR%	(4) Direct Contributions Amount	FR%	(5) Direct and Indirect Total Contributions Amount	FR%	(6) Total Contributions and Grants Amount	FR%	(7) Revenue (Membership, Investments, Fees, etc.) Amount	
Cancer (8/31/72)	$ 9,253,490	$ 84,122,445	11%	$74,852,086	12%	$78,728,609	12%	$78,906,853	12%	$79,075,086	12%	$ 5,047,347	6.0%
Heart (6/30/72)	7,362,687	56,481,745	13	50,973,587	15	46,766,885	16	51,059,497	14	52,923,395	14	3,558,250	6.3
Easter Seals (8/31/72)	6,345,592	52,879,487	12	48,765,330	13	28,977,915	22	30,881,573	21	41,351,686	15	11,527,711	21.8
Amer. Lung (3/31/72)	10,160,440	42,335,166	24	41,556,265	25	37,320,616	27	37,889,974	27	38,105,300	27	4,168,646	9.8
Natl. Found. (5/31/72)	6,645,224	36,027,495	19	28,799,612	24	35,379,000	19	35,379,000	19	35,379,000	19	648,495	1.8
Muscular Dyst. (3/31/72)	3,040,770	14,479,857	21	13,619,467	23	12,915,143	21	14,364,019	21	14,364,019	21	115,830	0.8
Arthritis (12/31/71)	1,363,064	9,876,865	14	9,289,969	15	6,134,545	23	9,276,274	15	9,473,851	15	405,034	4.1
Multiple Scler (12/31/71)	1,575,938	9,270,225	17	8,087,618	19	8,278,311	19	9,149,712	17	9,149,712	17	120,513	1.3
Cystic Fibrosis (2/29/72)	880,313	5,178,314	17	5,154,559	17	4,453,250	20	5,121,352	17	5,131,709	17	46,605	0.9
Epilepsy (12/31/72)	1,368,563	4,147,162	33	4,092,653	34	3,591,442	38	3,939,604	35	4,043,483	34	103,679	2.5
Hemophilia (6/30/72)	415,441	3,776,739	11	3,519,506	12	2,757,019	15	2,979,847	14	3,060,275	14	736,404	19.5
Kidney (6/30/72)	343,333	3,411,330	10	3,091,857	12	2,664,264	13	3,333,764	10	3,347,497	10	85,633	2.5
Diabetes (12/31/71)	225,287	2,503,191	9	2,603,774	8	1,073,869	21	1,564,519	14	1,592,029	14	911,162	36.4
Blindness (12/31/71)	394,685	2,620,628	14	2,593,377	15	2,547,027	16	2,736,010	14	2,736,010	14	94,618	3.6
Social Health (12/31/72)	65,882	732,927	9	634,630	10	235,127	28	701,285	9	701,285	9	30,742	4.2
Total Average	$49,640,766	$328,066,616	16%	$297,726,760	17%	$272,472,122	21%	$287,302 463	17%	$300,495,379	17%	$27,571,237	8.1%

Four NHC Voluntary Health Agency Members not included above since no consolidated statement available for 1971 or 1972. (National Council on Alcoholism; National Society for Autistic Children; National Safety Council and United Cerebral Palsy Associations).

Source: individual agency financial statements, 1972 (or 1971).

"Total income" includes all public support and revenue received by and committed to an agency during the year reported.

Note that the idea of "committed to" requires that the voluntary health and welfare organizations report their financial operation on an accrual basis (the recording of income and expenses when they become due).

Comparison of total fund-raising costs to total income is not an accurate measure of the returns resulting from the expenditures to raise money. The reason is that income includes interest earned on investments, unsolicited gifts, patient service fees, membership dues, and so forth, the inclusion of which bears no relation to the fund-raising effort. This ratio obviously can overstate the relative cost efficiency for raising money and understate the actual costs in relationship to the money returned for effort expended. It is less accurate as a measure of fund-raising efficiency as the income from revenue increases.

Column (3) - Total Expenses

The percentage in column 3 equals

$$\frac{\text{total fund-raising expenses}}{\text{total expenses}} \quad \text{(average = 17\%)}$$

"Total expenses" is the dollar value of all expenditures by the agency for the time period. The agency, however, may collect more or less than it spends for the time period. The FR cost in relation to total expenses may overstate or understate the return for the expense invested in raising the money actually brought in by the fund-raising effort. This ratio may be appropriate for comparing amounts spent for the period in relation to various types of programs or categories of expenses for which the agency was established. Table B-2 illustrates such a comparison for the NHC voluntary health agencies. Percentages of total expenses (a common base) for a program as well as for the supportive services such as fund-raising helps to place each in context. Such a comparison, however, may not be an accurate measure of the end-product results from the total expenditures for fund raising (note especially the comparison of the fund-raising percentage for the National Foundation, Table B-1 cols. 1 and 2). When compared with total income, the FR cost ratio, as expected, is less than when it is compared with total expenses for each of the organizations, except the American Diabetes Association, whose expenses exceeded income.

It should be pointed out here that an organization that does not spend all of its income may very well have projects underway for which there is no commitment but for which the expenditure is likely for payment in the following year. For some national voluntary organizations, the amount of uncommitted money varies by the time of the year, usually related to budgeting periods of the affiliated units receiving funds from the national body. A certain amount of operational flexibility of this type is essential for any businesslike planning for financial responsibility. The difference between income and expenses is technically, but may not actually be, a "surplus." It is to some extent a carry-over of resources for expected but uncommitted expenditures in the following fiscal period. Voluntary organizations should be encouraged to maintain a reserve of six months to a year of normal operating expenses to meet unexpected demands or to take advantage of unusual research or other program developments. (This is done by designating a certain amount of funds in program categories for such contingencies.)

Column (4) - Direct Contributions

The percentage in column 4 equals

$$\frac{\text{total fund-raising expenses}}{\text{direct contributions}} \quad \text{(average = 21\%)}$$

"Direct contributions," according to the *Standards*, is all the gifts or pledges of money received by the charitable organizations directly from donors and non-related organizations. This amount does not account for *all* income for which the organization spends time and resources to raise money, such as contracts or grants from government or private sources. This ratio often understates the agency's efficiency in raising money. Comparison of the FR percentages confirms that the percentage rate is usually higher for column 4 than it is for columns 2 and 3 and for the remaining columns.

Table B-2

Total Expenses with Percentages by Type of Programs and Supportive Activity, Fiscal Year Ending 1972 or 1971, Fifteen National Health Council Voluntary Health Agency Members

Agency (Fiscal year ending)	Total Expend.	Research	Public Ed.	Prof. Ed.	Comm. Serv.	Patient Serv.	Total Prog.	Manag. and General	Fund Raising	Total Admin.	Major Prop. and Equip. Acquisitions
American Cancer Soc. (8/31/72)	$74,652,000	31.5%	16.5%	10.5%	7.0%	12.5%	78.0%	10.0%	12.0%	22.0%	–
American Heart Assoc. (6/30/72)	50,972,557	32.0%	12.5%	13.5%	15.0%	–	73.0%	12.0%	15.0%	27.0%	–
Natl. Easter Seal Soc. (8/31/72)	48,765,520	1.0%	2.0%	2.0%	64.0% -	Inc. Pat. Serv.	69.0%	12.0%	13.0%	25.0%	6.0%
American Lung Assoc. (3/31/71)	41,556,265	4.0%	16.5%	9.5%	30.5%	2.0%	62.5%	11.0%	24.5%	35.5%	2.0%
National Foundation (5/31/72)	28,755,612	15.0%	15.0%	5.0%	13.0%	19.0%	67.0%	8.0%	23.5%	31.5%	1.5%
Muscular Dystrophy Assoc. (3/31/71)	13,619,467	24.5%	11.0%	3.0%	8.0%	26.0%	72.5%	5.0%	22.5%	27.5%	–
Arthritis Foundation (12/31/71)	9,309,969	25.2%	15.5%	11.0%	20.5% -	combined	72.0%	14.0%	14.0%	28.0%	–
National Multiple Sclerosis Society (12/31/71)	8,097,618	19.5%	12.0%	6.0%	8.0%	25.0%	70.5%	10.5%	19.0%	29.5%	–
National Cystic Fibrosis Research Foundation (2/29/72)	5,134,559	38.0%	18.0%	2.0%	9.0%	8.0%	76.0%	7.0%	17.0%	24.0%	–
Epilepsy Foundation (12/31/72)	4,082,612	4.0%	9.0%	5.0%	26.0%	8.0%	52.0%	15.0%	33.0%	48.0%	–
National Hemophilia Foundation (6/30/72)	3,519,506	2.0%	3.0%	1.5%	2.5%	70.0%	79.0%	9.0%	12.0%	21.0%	–
National Kidney Foundation (6/30/72)	3,091,957	25.5%	18.0%	8.0%	11.0%	15.5%	78.5%	10.0%	11.5%	21.5%	–
American Diabetes Assoc. (12/31/71)	2,683,774	9.0%	13.0%	14.5%	8.0%	31.5%	76.0%	11.0%	8.0%	19.0%	5.0%
Natl. Soc. Prev. of Blind. (12/31/72)	2,595,277	6.5%	34.5%	16.0%	20.0%	–	77.0%	8.0%	15.0%	23.0%	–
American Social Health Association (12/31/72)	634,830	27.5%	13.5%	2.0%	31.0%	–	74.0%	16.0%	10.0%	26.0%	–

Column (5) - Total (Direct and Indirect) Contributions

The percentage in column 5 equals

$$\frac{\text{total fund-raising expense}}{\text{total (direct and indirect) contributions}} \quad (\text{average} = 17\%)$$

The definition of what is "direct contributions" is provided in the preceding paragraph. "Indirect contributions" are donations to an organization raised through efforts of another organization such as a local affiliate, guild, trade association or civic club, and federated appeals.

"Direct and indirect contributions" is income from all private voluntary contributions, whether the agency recieves it directly from the donor, or via another source that, as an independent organization, spends money to raise it. Since the fund-raising expenses for the charitable agency include the costs of efforts to have its name included on the federated campaign or other association [illegible] of beneficiaries (preparation of materials for the soliciting organization's use, on-site vis[illegible]llow-up letters, and so forth), the material and personnel time investment represent an appropriate fund-raising expense to the agency. (The non-affiliated, soliciting group's expenses for raising the money is not included in the requesting organization's fund-raising expenses.) The point here is that the base (or denominator) for figuring the FR cost ratio should appropriately reflect all returns from the agency's fund-raising efforts. The agency FR cost ratio, however, will not provide the total community cost for raising the money received. It does give an approximate measure for total agency cost for the returns from contributions (only) that it worked to obtain, this ratio may not, however, be an accurate measure of the agency's fund-raising *efficiency*.

Column (6) - Total Contributions and Grants

The percentage in column (6) is

$$\frac{\text{total fund-raising expenses}}{\text{total contributions plus grants}} \; . \quad (\text{average} = 17\%)$$

"Total contributions (direct and indirect) plus grants" includes all money received from public contributions from all sources and returns from effort expended to obtain grant and contract money. (Where contracts for payment for services are negotiated, the agency still invests some time in developing proposals for the contract and thus this is part of the fund-raising process.) This sum deducted from total income should leave only that revenue derived from investments, membership dues, other program service and material fees or sales, all of which is money returns from program services rendered or from financial investments requiring no attributable expenditures by the fund-raising agency for the financial return.

None of the above ratios are perfect measures of the return on fund-raising effort invested. Considering the input for each base, total contributions (direct and indirect) plus grants reflects most comprehensively the total dollar return on agency fund-raising efforts.

Selected References

American Council of Voluntary Agencies for Foreign Service 1973 Annual Report. ACVAFS. New York, 1974.

Childrens Charities, 1974: Hearings Before the Subcommittee on Children and Youth of the Committee on Labor and Public Welfare, U.S. Senate, 93rd Congress, February 4, 5, 6 and March 11, 12, 1974. U.S. Government Printing Office, Washington, D.C., 1974.

Church World Service Annual Report 1973. National Council of Churches of Christ in U.S.A., New York, 1974.

Fitzgerald, Marilyn F. *Museum Accreditation: Professional Standards.* American Association of Museums. Washington, D.C., 1973.

"Fund-Raising to Contributions - Highest to Lowest" (1972),. New York State Registration Bureau, Special study report by Price Waterhouse & Co., New York, 1974.

Giving USA, 1974. American Association of Fund-Raising Counsel, Inc. New York, 1974.

Gross, Malvern J., Jr. *Financial and Accounting Guide for Non-profit Organizations.* New York: Ronald Press, 1972.

Gunn, Selskar M. and Phillip S. Platt. *Voluntary Health Agencies, an Interpretive Study.* New York: Ronald Press, 1945.

Johnson, Douglas A. *North American Inter Church Study: Motives for and Attitudes about Stewardship and Church Life.* National Council of Churches of Christ in U.S.A., 1971.

Leslie, John W. *Focus on Understanding and Support, A Study in College Management.* American College Public Relations Association. Washington, D.C., 1969.

Leslie, John W. *Seeking the Competitive Dollar: College Management in the Seventies.* American College Public Relations Association. Washington, D.C., 1969.

McGrath, Kyran. *1973 Museum Salary and Financial Survey.* American Association of Museums. Washington, D.C., 1973.

Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations. National Health Council, National Assembly. New York, 1964.

Thiessen, V. *Who Gives a Damn? A Study of Charitable Contributions* (doctoral thesis, University of Wisconsin). Ann Arbor, Michigan: University Micro Films, 1968.

Viewpoints on State and Local Legislation Regulating Solicitations of Funds from the Public. National Health Council. New York, 1971.

Voluntary Foreign Aid Programs. Department of State, Agency for International Development. Washington, D.C., 1973.

Voluntary Health and Welfare Agencies in the United States. An Exploratory Study by an Ad Hoc Citizens Committee. New York: The Schoolmasters' Press. 1961.

DEDUCTIONS FOR LOBBYING BY PUBLIC CHARITIES: CONSTITUTIONAL ISSUES, PUBLIC POLICY, AND THE TAX REFORM ACT OF 1976

EDITOR'S NOTE

In recent years there has been criticism of the Revenue Code's restrictions on the availability of deductions for donations to the lobbying programs of private charities, and there have been several proposals for lessening these restrictions. The Commission sponsored papers examining both the advantages claimed for the restrictions and the advantages claimed for lessening them. The two papers had already been drafted when Congress enacted the Tax Reform Act of 1976, section 1307 of which loosens the restrictions by permitting public charities to carry on certain amounts of lobbying activities funded by donations for which donors have taken tax deductions.

The first Commission paper, by John B. Huffaker, Esq., reports that critics of the pre-1976 act restrictions argue that the statutory terms are difficult to define, resulting in inconsistent enforcement; that legislators are deprived of expert advice from charities; that charities should not be treated differently from trade associations; and that charities are inhibited by the Code restrictions from discussing legislation with their own members. The Huffaker paper reports that supporters of at least some restrictions on deductible lobbying urge that lobbying is not the sort of activity that charities should engage in; that the tax benefits for donations to charity should not be increased; and that the vagueness of the law serves the positive end of ensuring that charities remain outside of the lobbying process. The paper suggests that there is agreement among most students of the issue that charities should be allowed to lobby on bills affecting their statutory attributes, such as their charters or their tax benefits, and that charities should not be allowed to participate in campaigns for public office. The paper concludes by recommending that Congress take action to define the statutory terms and limits more precisely, so as to encourage charity lobbying.

The second Commission paper, by the Commission staff with Professors Michael J. Graetz and John C. Jeffries, Jr., argues that there is no preference for business lobbying in the pre-1976 statutory framework; that the denial of deductions for donations to charity lobbying programs imposes no meaningful restrictions on the constitutional rights of donors or of charitable groups; and that the old rules are not constitutionally vague. The paper takes the view that allowing deductions for donations to lobbying programs would disproportionately subsidize the speech of the wealthy, and would encourage churches to lobby for government subsidies; that it is appropriate to the nature of charities to restrict them to nonpartisan legislative activities; and that much charity lobbying would be for government subsidies, which would erode the independence of the charitable sector.

The Tax Reform Act of 1976 allows charities to lobby within limits based on percentages of the total budgets of the groups. Charities must elect to come within the new rules; churches and church groups may not make the election. The act defines the more important terms, such as "influencing legislation," associated with the issue.

The provisions of the act, and the official reports on the legislation, give some indication of how Congress felt about the arguments raised in the Huffaker and the Graetz-Jeffries papers.

Generally, the Reform Act will encourage charities to carry on lobbying programs. The act increases the tax benefits associated with charity by allowing donors deductions for contributions to lobbying programs. No limits apply where charities are lobbying concerning their statutory attributes. Charities may not participate in campaigns for public office. These provisions were adopted because, in part, Congress believes that the old rules are unclear, that the lack of clarity might lead to subjective enforcement, and that the severe sanctions of the old rules (because the only unambiguous action which IRS could take, as a practical matter, in the case of violations was to withdraw a charity's "deductible status") presented an enforcement problem. (Most of these points are covered in the Huffaker paper.)

The House, Senate, and Conference reports on the act generally do not take the position that charities are discriminated against as compared with business groups, nor that the old rules are constitutionally suspect. The new rules do allow wealthy donors to take deductions for donations to lobbying activities by qualifying charities. The act attempts to continue limitations on church lobbying. (These are issues discussed in the Graetz-Jeffries paper.) If the Congress is concerned about overly partisan charity lobbying or charity lobbying for government funds (there is little if any evidence of congressional concern on these two points), it has responded to such concerns only by limiting the lobbying to certain percentages of charity budgets.

LEGISLATIVE ACTIVITIES OF CHARITABLE ORGANIZATIONS OTHER THAN PRIVATE FOUNDATIONS, WITH ADDENDUM ON LEGISLATIVE ACTIVITIES OF PRIVATE FOUNDATIONS

Pepper, Hamilton & Sheetz†

I

SUMMARY OF PRESENT LAW

Section 501(c)(3)

Section 501(a) of the Internal Revenue Code of 1954 generally exempts from taxation organizations described in section 501(c). Section 501(c)(3) of the Code includes charitable organizations, and provides as follows:

> Corporations, and any community chest, fund, or foundations, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, *no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation*, and which does not participate in, or intervene in, (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office. [Emphasis added.]

This section of the paper examines the "substantial activities" provision of section 501(c)(3), with particular emphasis on the question of when lobbying activities are deemed "substantial," thereby resulting in loss of exempt status under section 501(c)(3). The Code does not attempt to define or explain the term "substantial part of the activities" for purposes of section 501(c)(3).[1]

Regulations: Section 1.501(c)(3)-1

Section 501(c)(3) requires as a condition of exemption that an organization must be both organized and operated exclusively for an exempt purpose. The provisions of the regulations under section 501(c)(3) applicable to lobbying activities are contained in Regulations §1.501(c)(3)-1(b), which sets forth the rules relating to the "organizational test," and Regulation §1.501(c)(3)-1(c), which sets forth the rules relating to the "operational test."

Regulation §1.501(c)(3)-1(b)(3) provides as follows:

> An organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it
>
> (i) To devote more than an *insubstantial part* of its activites to attempting to to influence legislation by propaganda or otherwise; or
>
> (ii) Directly or indirectly to participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of or in opposition to any candidate for public office; or
>
> (iii) To have objectives and to engage in activities which characterize it as an "action" organization as defined in paragraph (c)(3) of this section.

---

†Philadelphia.

> The terms used in subdivision (i), (ii), and (iii) of this subparagraph shall have the meanings provided in paragraph (c)(3) of this section. [Emphasis added.]

Thus, an organization whose articles expressly permit devotion of more than an "insubstantial part" of its activities to lobbying will fail the organizational test. The regulations do not define the term "insubstantial part."

Regulation §1.501(c)(3)-1(c)(3) states that an organization will fail the operational test if it is an "action" organization as defined in subdivision (ii), (iii), and (iv), and provides in relevant portion as follows:

> (ii) An organization is an "action" organization if a substantial part of its activitites is attempting to influence legislation by propaganda or otherwise. . . . An organization will not fail to meet the operational test merely because it advocates, as an insubstantial part of its activities, the adoption or rejection of legislation.
>
> (iii) An organization is an "action" organization if it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office. . . .
>
> (iv) An organization is an "action" organization if it has the following two characteristics: (a) Its main or primary objective or objectives (as distinguished from its incidental or secondary objectives) may be attained only by legislation or a defeat of proposed legislation; and (b) it advocates, or campaigns for, the attainment of such main or primary objective or objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public. In determining whether an organization has such characteristics, all the surrounding facts and circumstances, including the articles and all activities of the organization, are to be considered.

Regulation §1.501(c)(3)-1(c)(3)(ii) does attempt to delineate certain activities which will constitute an attempt to "influence legislation." No attempt is made, however, to define the term "substantial activities."

Case Law

The reported cases do not clarify what is meant by "substantial" activity to influence legislation, although the present provision was first enacted in the Revenue Act of 1934. Rather, the courts have considered each case in an *ad hoc* fashion.

In *Martha Hubbard Davis,*[2] the court found that the organization in question had not violated the substantial activity provision of section 501(c)(3) and stated that the legislative activities constituted a "very small part" of the general activity of the organization. The court stated further that such activities were "purely incident to its main and controlling purpose and activity" which was purely charitable and educational. The court apparently considered several factors in reaching its decision, such as the portion of legislative activity in relation to the organization's general activity, and whether such activities were merely incidental to the organization's primary purpose and activity.

The Sixth Circuit appears to be the only court which has attempted to provide a formula to determine the meaning of "substantial." In *Seasongood v. Commissioner,*[3] the court held that the devotion of less than 5 percent of a nonpartisan, good-government league's time and effort to legislative activity was not "substantial." In *Christian Echoes National Ministry v. United States,*[4] the court rejected the percentage test of *Seasongood,* stating, "A percentage test to determine whether the activities were substantial obscures the complexity of balancing the organization's activities in relation to its objectives and circumstances." The court then denied section 501(c)(3) status to the organization, finding that its legislative activities were "an essential part" of its program and that such legislative activities were not "incidental, but were substantial and continuous."

In *League of Women Voters* v. *United States,*[5] the court refused to consider only the number of hours spent on direct lobbying, but included the time and effort spent at the chapter level in formulating and discussing positions to be taken by the League on various proposals. The court, in denying section 501(c)(3) status to the League, also stated that its legislative activities were not insubstantial, and that the influencing of legislation was the League's "main purpose and reason for being." Courts have also considered the method used for lobbying activity and the purpose behind the activity in question. See, for example, *Roberts Dairy Co.* v. *Commissioner;*[6] *Christian Echoes National Ministry* v. *United States.*[7]

It is readily apparent that the cases offer no clear guidelines as to what constitutes "substantial" activity for purposes of section 501(c)(3). The present state of the law is perhaps best summarized by the Tax Court in *Martha Hubbard Davis:*

> The question is always one of fact to be determined upon the record of purely charitable activities and activities influencing legislation and a comparison of the two. Under such conditions the decisions of the courts in other cases are of little value.[8]

Section 162(e)

Prior to 1963, expenditures in furtherance of an attempt to promote or defeat legislation, either before a legislative body or before the general electorate, were not deductible under section 162 of the Code, notwithstanding the direct relationship of the expenditures to the taxpayer's trade or business. *Textile Mills Securities Corp.* v. *Commissioner;*[9] *Cammarano* v. *United States.*[10] In *Cammarano* the court compared the legislative activity limitation of section 501(c)(3) of the Code with section 162.

These cases were overrulled by the enactment of section 162(e) in 1962. Section 162(e) permits deductions for expenditures in furtherance of direct lobbying activities of direct interest to the taxpayer's trade or business and for expenditures connected with communication of information between a taxpayer and an organization of which he is a member with respect to legislation of direct interest to the taxpayer. Expenditures related to political campaigns or to "grass roots" lobbying activities are not deductible. The legislative history of section 162(e) suggests three reasons for the change of prior law: one, the presentation of such information to the legislators is necessary to a proper evaluation on their part of the impact of the present or proposed legislation; two, the administrative problem of separating expenses disqualified under prior regulations from deductible business expenses; and three, the anomaly of permitting deductions for expenses incurred in judicial or administrative appearances while denying deductions for appearances before legislative bodies.[11]

II

SUMMARIES OF ARGUMENTS

To give a better understanding of the development of the proposed legislation, there is presented below the views of proponents and opponents of change, either liberalizing or restrictive, and of some areas in which, if there is not actual agreement, there appears to be very little debate.

Major Arguments in Favor of Corrective Legislation

Uncertainty of Present Law Should be Corrected

Probably the major objection to present law is related to its uncertainty. Although the present law has been in effect for approximately 40 years, neither the courts nor the Internal Revenue Service has been able to derive a universally acceptable definition of "substantial." The Service has refused to take a position on the meaning of substantial in quantitative terms, such as what percentage of expenditures or time devoted to lobbying activities would be deemed insubstantial.[12] Moreover, the Service has at times attempted to view the term "substantial," not only in undefined quantitative terms, but in undefined qualitative terms as well. A "facts and circumstances" test, apparently called for by the Regulations, takes the bewildered charities out of definable areas, such as specific financial expenditures and allocations of staff time, and into completely uncharted areas, including not only time of volunteers, but importance of the effort, and very possibly other factors. This appeared to be the case in the Service's attempt to revoke the section 501(c)(3) status of the Maryland Association for Mental Health, Inc., largely on the grounds that the association had engaged in substantial lobbying activity through the use of unpaid volunteers.[13]

While such uncertainty gives the Service flexibility, this is exactly what is objectionable to the charities. As Mortimer Caplin pointed out in his testimony before the House Committee on Ways and Means,[14] revenue agents are normally accounting majors, not philosophy majors, and it is almost impossible to tell what one of them would decide on a given set of facts. Inconsistent enforcement of the law by the Internal Revenue Service would naturally follow.

When a charity's exemption is revoked, no matter how tenuous the grounds, it takes a considerable period of time to get the action reversed, whether by administrative or court action.[15] During this period, the charity cannot assure contributors that their contributions will be deductible, and the normal programs of the charity would inevitably suffer drastically. In many instances, loss of contributions will result in total and permanent cessation of the organization's charitable activities: thus the charities' desire to have a test or tests considerably more specific than that (or those) found under present law.[16] The ideal, from their standpoint, would be a law that could be translated into dollars. Then they could assure themselves, by staying well under those limits, that their exemption would not be questioned.[17]

Charities Should be Heard From by Governmental Bodies (Federal, State, and Local) – Both Volunteer Members and Staff

Governmental bodies often wish to receive their ideas and reasons. The substantiality test of section 501(c)(3) does not totally prohibit legislative activity by charitable organizations. As a result, however, of the vagueness of the present standard and the harshness of the sanction imposed for violation of the standard, charitable organizations are generally reluctant to provide more than a minimal, if any, input into the legislative process.

Legislative bodies are often desirous of receiving ideas and information from charitable organizations, particularly in view of the fact that federal and state governments have taken an increasingly active role in fields that were previously the almost exclusive domain of charitable organizations, such as health, welfare, education and environmental matters. Examples of the desirability of charities contributing their ideas and information to legislative bodies are numerous. In considering the budgeting structuring and priorities of a health program, Congress would almost surely want the benefit of the expertise of the staffs and the opinions of the executives of leading health agencies, even though (and perhaps particularly because) they would frequently be in conflict. In considering pollution laws, a state legislature would probably wish to weigh the arguments and supporting facts of businesses that would be affected, and also of any 501(c)(3) groups which had studied the situation. County and town governmental bodies, in determining how to allocate revenue sharing funds in its budget, would want to consider the arguments in support of both projects of interest to private groups and projects promoted by public welfare groups. By requesting such information, all those legislators will be better able to make informed decisions more responsive to the needs of all their constituents.

Charities should also be allowed to volunteer information and suggestions. Proponents of corrective legislation point out that responding to specific requests by governmental bodies is far from a complete solution to the basic problem: too often bills can slip through or other governmental action can be taken without the recognition of possible drawbacks or problems that informed charities could identify. For example, a committee concerned with improving water transportation in Florida by building a cross-peninsula canal may be unaware of the ecological consequences such a canal would have on water flow patterns into the Everglades. Unless concerned conservation groups are allowed to approach the committee with their information describing the problem, legislative action may be taken that could threaten the very existence of the Everglades. Such a threat might be avoided if interested charitable organizations are permitted to provide legislators with the benefit of the information they have available on the problem.

For any public charity, legislative activity, direct or indirect, is a relatively minor part of its reason for existence; yet, though minor, it can nonetheless be important. For example, the major purposes of the Cancer Society are to find a cure for the disease, treatment for the afflicted, and education for the public so that its members will be aware of the need for early treatment. At the same time, the Society would be handcuffed if it could not, on its own motion, come before governmental bodies with its facts, figures, and opinions on legislative matters affecting the work of the organization. The major purpose of a university is education: yet members of its board of trustees and faculty boards should be allowed to comment on legislation affecting higher education. In either case, the amount of time or money relatve to the entire operation of the organization might and probably would be small, but it is nonetheless important, both to the charity and the governmental body.

Charities Should Be Allowed Basically the Same Rights as Trade Associations

Section 162(e) of the Code, discussed earlier, grants to business entities the right to deduct as ordinary and necessary expenses amounts paid or incurred in connection with legislative activity of direct interest to the business including, specifically, that portion of the dues paid to any trade association of which the business is a member which is attributable to such legislative activity. The argument for equal treatment under the tax law is obvious.[18]

The committee reports accompanying the enactment of section 162(e) suggest three reasons[19] for the change in law which appear to apply to charitable organizations. It is almost inconceivable that Congress would wish to hear the views of business organizations, but not those of charities. Likewise, it is inconsistent, for instance, to permit charities to present their views to an administrative agency charged with the duty of drafting interpretive regulations, such as the Environmental Protection Agency, yet deny charities the opportunity to present such views to Congress.[20]

The inequity of present law is reflected in the remarks of Senator Edmund S. Muskie (D-Me.) made in support of S. 1408 (92d Congress, 1st Session (1971)), a bill permitting charities to engage in direct lobbying activites:[21]

> It is fundamental to our constitutional system that they should have equal access along with business groups and others in presenting views to Congress. This is so, not because the views of the public interest groups are necessarily correct, but because in considering the increasingly complex matters which come before it, the Congress should hear and weigh all views to the fullest extent possible.[22]

The Right to Communicate with Members is Critical to the Proper Functioning of Most Charities

The fuzziness of present law brings into sharp relief the problems encountered by charities with respect to communications with their members. For the charity to be representative of its membership, there must be freedom of exchange of views – by correspondence, published magazines, and orally at meetings. The members must know what the directors, officers, and staff are thinking, and vice versa. The issues may involve matters that are or could be the subject of legislation or other governmental action. If such communications are considered to be "attempts to influence legislation" or propaganda, it could leave a carefully administered organization in a real straitjacket.

Many public charities, particularly the large national bodies, are "membership" organizations, that is, they charge dues to individuals who become members and receive certain rights, such as the right to vote for officers and on matters of policy, to receive publications, and to attend various seminars. In this regard, it may be important to distinguish the national organization from its affiliated or subsidiary chapters. For example, a national health organization might have many regional or state chapters, and it might also have many individual members – sometimes of the regional chapter, sometimes both. At the national level present law may create difficulties in distinguishing between communications with members and grass-roots lobbying. In any event, the officers and staff of the organization cannot represent the membership unless there is a relatively free flow of information and opinion back and forth.

Congressman Joe D. Waggoner (D-La.) has expressed the fear that the spokesmen of organizations may be presenting their own views rather than those of the people they represent.[23] This fear, rather than being persuasive argument against corrective legislation, points to the benefit of permitting an organization to communicate freely with its members. In this connection, Dr. Elvis J. Stahr stated:

> It seems to me, that in restricting the right of an organization to communicate with and within its own membership, one is striking at the very heart of a public charity by cutting the flow of information between a national staff and its constituent members around the country.
>
> This runs the risks of detaching the staff from the very people that provide the resources with which the organization pursues its purposes.[24]

The problem arising from distinguishing between such communication and grass-roots lobbying can be resolved by an appropriate definition of members that insures against misuse of the privilege.

Major Arguments Against Corrective Liberalizing Legislation

The Right to Lobby Should Be Restricted Rather than Increased

Although there are areas in which lobbying can be quite helpful to governmental officials, it should not be allowed to "run wild"; particularly it should not be subsidized, either directly or indirectly. Lobbyists have their own special axes to grind, and necessarily take a tremendous amount of time out of the busy days of governmental officials and their key assistants. Lobbying can be good, but it should be severely restricted or the harm outweighs the good. Section 162(e) was a mistake. Perhaps charities should be given the same "rights" as trade associations and business corporations, but this should be done by forcing everyone to lobby with after-tax dollars. Thus, it has been argued that lobbying expenditures of a corporation should not be deductible, section 162(e) should be repealed, and section 501(c)(3) should be tightened.

Although it Might Well Be That the Law Should Be Clarified, the Clarification Should Not Result in Charities Being Allowed Additional Rights

The heart of the problem is the underlying public policy that grants the favored tax status. Historically the ground has been that the favored tax status is justified because the charity relieves financial burdens that would otherwise fall on the government. The predominant theory is reflected in the following statement from the report of the Committee on Ways and Means in 1938:

> The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriation from public funds, and by the benefits resulting from the promotion of the general welfare.[25]

When charities are influencing legislation, the frequent objective is to promote the expenditure of funds for a particular purpose. While this sort of activity may help the legislators better realize the needs of the country, it does not provide any of the funds that are vital to satisfy the need to which the charity has drawn attention.

This would lead to the limitation on charities of lobbying when the concern is the ability of the charity to conduct its program. For example, the charity has a direct interest in the allowance of the charitable deduction. A charity would have a direct interest in the application of building codes to structures it proposes to erect or minimum wages paid its employees. On the other hand, this line of reasoning would not permit an effort by the charity to secure funds from the government to carry out programs that it conceives to be in the national interest.

The proponents of this line of reasoning feel that section 162(e) should not be a precedent for allowing a massive lobbying effort by charities.[26] Rather, they regard section 162(e) with reservations and feel that the sort of activities appropriate for private foundations (Section 4945(e) and Regulation §53.4945-2(d)) is as much as any charitable organization should be permitted.

It should be noted that this argument is not as much opposed to changing present law to assure greater certainty as it is to a liberalization of present law in favor of permitting more lobbying activities.

There Is No Need for Change: This Is One Area of the Law in Which Vagueness Is an Attribute

The very vagueness deplored by the charities is actually an advantage rather than a detriment. Despite their complaints, well-run charities have appeared to manage to get their points across without being attacked by the Internal Revenue Service. Lobbying is and should be only a minor part of the activities of a tax-exempt organization. Such organizations are compelled to take great care not to violate the vague regulations, and do so. The result of this is that they are properly cautious and make themselves heard only on matters of extreme importance to them: at that point, they can be assured of a good hearing, as those they are addressing know the importance of the matter to the charity. Those who wish to use tax-exempt dollars (both income and contributions) to do a substantial amount of lobbying can then be compelled to change their status. Thus, the failure of the Service to promulgate Regulations that would give a more precise definition to the word "substantial" represents a sound policy decision, not just a fear to come to grips with a difficult problem.

Major Arguments in Favor of Careful Restriction of Any Corrective Legislation

The Right to Lobby Directly Should Be Severely Restricted (Though Allowed Under More Definite Rules Than at Present) – Otherwise There Would Be Available a Gigantic "Slush Fund" for Charitable Lobbying

Proponents of this theory accept the proposition that vagueness is undesirable and therefore that tests should be mathematical rather than philosophical, but point out that failure to impose specific and rather severe limitations, particularly on direct lobbying, could result in creation of a monster. Budgets of large charities are enormous, and expenditure of a substantial percentage (such as 20 percent) of such budgets could result in deluging Congress and other governmental bodies with lobbyists operating with tax-free dollars. Assistant Secretary Cohen noted this forcefully in his testimony in 1972 and produced figures indicating that 20 percent could result in a lobbying fund of $6 billion.[27] This is far more than public charities should need.

A solution offered was adoption of a principle of "reverse graduation," that is, the greater the budget, the smaller the percentage allowed to be spent on direct lobbying, combined with an overall flat dollar ceiling for each charitable organization. Adoption of such a solution could, however, lead to the use of affiliated organizations to avoid the lower limitations. Appropriate restrictions might protect against such practice.[28]

The Right to Deal with Members Should Be Restricted, for Fear of "Grass Roots" Lobbying

Recognizing that a certain amount of communication with members on matters relating to actual or proposed legislation is important to many charities, there should nonetheless be careful limitations placed on this right. The danger of not so limiting these activities is that a "membership list" can easily become simply an enormous mailing list, so that letters or flyers sent to the "members" become only a thinly disguised effort at grass-roots lobbying. Any liberalizing legislation should protect carefully against this possibility.

Any New Legislation Should Be Carefully Structured To Impose Narrow Limits on "Grass Roots" Lobbying

True grass-roots lobbying should be severely restricted. This is a direct attempt to influence the public and should not be an important part of the activity of any tax-exempt organization (or, at least, any organizations, contributions to which are tax deductible). Thus, while allowable, the limitations should be even more severe than under present law. In addition there should be a certain amount of vagueness left in at least this area, so that qualitative as well as quantitative tests could be used.

Public Charities That Lose Their Section 501(c)(3) Exemption Should Not Be Allowed to "Walk Away" With a Large Endowment Created With Tax-Deductible Dollars

Under present law, a charity which has built up a large fund with tax-deductible contributions and then lost its section 501(c)(3) status because of unreasonable lobbying activities could, under certain circumstances, become a section 501(c)(4) organization with unrestricted use of the endowment fund so created. Such use for lobbying activities beyond the scope of present law (or any new law relating to the lobbying rights of section 501(c)(3) organizations) would destroy the purpose of such law. Careful provision should be made in any new law to protect against such a possibility.

Areas of Apparent Agreement

Areas of "Self-Protection" – Analogy to Provision for Private Foundations

In 1969, Congress, while radically altering the law with respect to private foundations as a result of years of severe criticism of the activities of many of them, nonetheless passed section 4945(e), which specifically gave them the right to lobby to protect their existence and tax status. It seems to be taken for granted that public charities have that right under present law, and that any new law should contain a specific provision granting such right.

Providing Technical Advice to Governmental Bodies

Many charities have large and competent staffs which have engaged in extensive research, the results of which can often be helpful to governmental bodies. It appears to be agreed that furnishing such information upon request of a legislative body should not "count against" whatever amount of lobbying activity the charity is allowed.[29]

Making Available Research Results

Furnishing the results of nonpartisan study should not be treated as "legislative activity." The argument for such treatment for requested technical advice is equally applicable to research results.[30]

Influencing Elections

There is agreement that there should be no liberalization of the prohibition against any attempt to influence any election involving candidates for public office.

III

RECENT LEGISLATIVE PROPOSALS

On August 2, 1974, the Ways and Means Committee gave tentative approval to a proposal put forth by Congressman Barber B. Conable (R-N.Y.) to amend section 501 by inserting a new section 501(f).[31] The new section would have the effect of defining the term "substantial" for all organizations electing to come under its provisions. Mr. Conable's proposal was the last in a series of bills which had been introduced in the preceding several years in both Houses of Congress, all seeking to achieve essentially the same goal. A brief look at the succession of proposals and their terms highlights some of the issues involving legislative activity by tax-exempt organizations.

All of the proposals have distinguished between public charities and private foundations. They assume that the former, by virtue of their public nature and their openness to public scrutiny, are unlikely to require detailed legislative regulation, whereas the latter were dealt with specifically in the Tax Reform Act of 1969.

The first of these proposals was introduced by Senator Edmund S. Muskie (D-Me.) and Congressman James W. Symington (D-Mo.) on March 31, 1971.[32] They found inconsistent the policy of permitting the businesses to lobby under section 162(e) while effectively denying the same right to charities.

The Muskie-Symington bill was based on an American Bar Association resolution adopted in 1969.[33] It permitted charities to lobby with respect to legislation or proposed legislation, so long as it was of direct interest to the organization. It also permitted communications between the organizations and their members or contributors on those matters. It did restrict "grass roots" lobbying and political campaign activities, but contained no other limitations.

Although there was broad support for the Muskie-Symington bill, concern was expressed that the bill "might be interpreted to permit a public charity to devote its predominant activities to legislative efforts."[34] As a result, Senators Muskie and Hugh Scott (R-Pa.) introduced a new bill on January 24, 1972, which was identical to the Muskie-Symington bill except for one additional limitation: The organization must be one that "normally" devoted "substantially more than one-half" of its expenditures in pursuance of its exempt functions other than lobbying.[35] The Tax Reform Act of 1969 interpreted "substantially more than one-half" as 65 percent, and "normally" as requiring, generally, reference to a four-year period of an organization's experience.[36]

Discussion on the Muskie-Scott bill led to further compromise and considerable refinement which culminated in the introduction on March 9, 1972, of a bill by Congressmen Al Ullman (D-Oreg.) and Herman Schneebeli (R-Pa.). This bill not only permitted direct lobbying; it also permitted charities to undertake a limited amount of "grass roots" activity. In addition, any attempt to influence legislation of direct interest to the organization through communication of information between the organization and one or more of its members was also considered a part of the charity's total lobbying effort.

So long as amounts paid for grass-roots activities did not exceed 5 percent of total current expenditures and amounts expended for all types of lobbying did not exceed 20 percent, the charity would not lose its preferred status.

The bill further provided that making available the results of nonpartisan analysis, study, research, providing technical advice or assistance to a governmental body in response to a written request, or appearances, before legislative bodies with respect to decisions that could affect an organization's existence or status were not to be considered "attempts to influence legislation." Every subsequent bill proposing amendment of section 501 has contained similar exclusions.

This bill was the subject of three days of hearings, on May 3, 4, and 5, 1972, before the House Committee on Ways and Means. In those hearings, Russell Train, the chairman of the President's Council on Environmental Quality, supported liberalization of existing law.[37] However, the Treasury Department, though supporting the objectives of the bill, objected to certain features, expressing particular concern that its 20 percent limitation could make possible the accumulation of immense lobbying "slush funds."[38] The charitable organizations, on the other hand, supported the bill's quantitative tests with its 20 percent - 5 percent feature. The tests were considerably more specific than the substantiality test and could be easily translated into dollars.

On March 1, 1973, Congressmen Ullman and Schneebeli introduced a new bill, reflecting the testimony given in the hearings.[39] This bill made some dramatic changes. It adopted a reverse graduation feature to limit expenditures for direct lobbying. This feature responded to the "slush fund" argument. The bill then grouped all other lobbying activities together, thereby including grass-roots activities with activities involving communication between the organization and its members. The bill proscribed all but an "insignificant" amount of such activities. The bill also contained a penalty clause that in effect fined charitable organizations which undertook proscribed legislative activities in addition to revoking their preferred status under section 501(c)(3).[40] This provision was inserted to protect against the possibility of a public charity losing its section 501(c)(3) status with a large endowment fund, created with tax-deductible dollars, that could then be expended without limitation on lobbying activities.[41]

Another feature of the Ullman-Schneebeli bill was a new provision relating to affiliated organizations. This provision required that if two or more organizations are effectively controlled, directly or indirectly, by the same person or persons, one of which was a section 501(c)(3) organization electing to have its lobbying activities regulated in accordance with the amendment, the two organizations would be treated as one and the same for purposes of the bill. Some such provision would appear to be required so long as a "reverse graduation" principle is used.[42]

The bill also had a provision relating to section 501(c)(4) organizations[43] and a self-terminating provision.[44]

There was objection on the part of charitable organizations to certain features of the second Ullman-Schneebeli bill. While they accepted in principle the reverse graduation feature, they were greatly concerned with the penalty clause and with the fact that communication with their membership was effectively denied to them. In response to that expressed concern, Congressman Barber B. Conable (R-N.Y.) introduced a compromise bill on December 19, 1973.[45] The Conable bill retained most of the provisions of the second Ullman-Schneebeli bill, but excluded communications with members from the definition of influencing legislation, and deleted the penalty tax provision, the provision relating to section 501(c)(4) organizations, and the self-terminating provision.

When the bill reached the Ways and Means Committee, the committee tentatively adopted it with the addition of three provisions. The first reintroduced the self-terminating provision of the second Ullman-Schneebeli bill. The second related to the problem of removal of the "pre-tax endowment fund" and represented an effort to solve this problem without the severe provisions of the penalty tax of the second Ullman-Schneebeli bill, which the charities had condemned as being unduly harsh. The substitute provision has only prospective effect on the charity and its accumulated contributions. Upon loss of 501(c)(3) status an organization would be prevented from obtaining exempt status under section 501(c)(4) or from making a liquidating distribution of its assets to any related or affiliated organization.

Finally, the provision defining affiliated organizations (which had first surfaced in the second Ullman-Schneebeli bill) was expanded. The committee set forth a two-pronged test for affiliation: 501(c)(3) organizations would be deemed affiliates if (1) one organization could, under its governing instrument, impose upon another decisions on matters of legislative policy, or (2) the organizations were under common control, which was defined as having sufficient members in common on the governing board of each organization who by aggregating their votes had voting power to cause or prevent action by both organizations on legislative issues.

The draft of the bill prepared for final action by the Ways and Means Committee departed from the Conable Bill in several respects. It changed the approach of previous drafts, making it difficult to compare them. In doing this, it introduced two new terms, "qualified lobbying amounts" and "exempt purpose expenditures." The former term included direct lobbying and certain communications with members.

These and other changes from the Conable Bill appeared sufficiently far-reaching that it was impossible to arrive at an acceptable draft to include in the final bill approved, under much time pressure, by the committee. Accordingly, the committee, at the suggestion of Congressman Conable, deleted the entire proposal from its bill.

IV

CONCLUSION

The bill preliminarily approved by the Ways and Means Committee appeared to have considerable merit as a solution to the troublesome problems considered herein. Like all compromise proposals (and it represents a compromise on a compromise on a compromise on a compromise) it does not completely satisfy anyone. The charities naturally prefer, in that order, the Muskie-Symington bill, the Muskie-Scott bill, and the first Ullman-Schneebeli bill and see no important reason for the additional restriction placed upon them, particularly as they observe that no such restrictions are placed on trade associations and business organizations. Certain charities find certain provisions of the bill repugnant (notably the low percentage dollar figures allowed for direct lobbying) or difficult to work with on their particular set of facts. There is also considerable dispute over the penalty provisions. At the same time, those who favor further limitations on lobbying, or favor the (perhaps intentional) vagueness of present law could not be counted in support of this measure.

On the other hand, the proposed bill would accomplish a great deal. It would take care of the major concerns of the charities by allowing three things:

1. Definite provision with respect to direct lobbying. Though restricted by the reverse graduation feature, most charities feel they can accomplish their proper objectives within these limits.

2. Freedom to communicate on proper subjects with bona fide members. The important definitions in this area are left to Treasury Regulations, with whatever guidance the department might get from the Committee Reports.

3. Some residual protection for any combination of grass-roots lobbying and minor expenditures in any other area. The charities are, of course, unhappy about the prospect of another vague test, but nonetheless are given some kind of "security blanket" in this catch-all provision. Again, the Committee Reports and Regulations should be helpful in this area.

At the same time, the proposed bill undertook to answer nearly all the objections voiced to the earlier, broader proposals by those who favor the general objectives of the original ABA proposal and Muskie-Symington bills, but who, at the same time, desired various restrictions to prevent abuses:

- The reverse graduation principle answers the argument of the "slush fund," and the affiliated organization provision should prevent avoidance of the principle by use of multi-organizations.
- Communications with members, a proper and necessary part of the function of the charities, will be carefully limited to bona fide members to prevent back-door grass-roots lobbying.
- The "insignificant" catch-all provision leaves some vagueness in the law as a warning to charities, and will be interpreted as less than "substantial."
- Charities losing their exemption will not be allowed to take with them a lobbying slush fund created with tax-deductible dollars.
- The self-terminating provision compels Congress and the administration to review the operations of the bill within five years and determine whether its objectives have been accomplished and what, if any, amendments should be made.

Proponents of broader change may consider the proposed bill deficient in several aspects. For example, the bill does not place charitable organizations on total parity with trade associations, and continues to provide loss of exempt status as the only available sanction for violations. On the other side of the coin, some may believe the bill to be too liberal; for example, the bill places no limitation on the use of volunteer help for direct lobbying activities. Nevertheless, the bill represents a vast improvement over present law. It provides reasonably definite standards for the Internal Revenue Service and the courts, who must enforce the law, as well as for the organizations who must comply with the law.

Consideration of future legislation might well start with a comparision of the first Ullman-Schneebeli bill (H.R. 13720, 1972), and the Conable Bill (H.R. 12037, 1973) with the amendments tentatively accepted by the Ways and Means Committee. An acceptable solution somewhere in this area should be capable of being reached.

V

RECOMMENDATIONS: LEGISLATIVE ACTIVITIES OF CHARITABLE ORGANIZATIONS OTHER THAN PRIVATE FOUNDATIONS

We believe there are three fundamental portions of any legislative recommendation:

1. In order to give charities that are quite interested in the legislative field clear guidelines, an expenditure test should be expressed in the statute.

2. The expenditure guidelines are meaningless unless they are combined with a clear definition of what constitutes "influencing legislation."

3. For the great majority of charities, the present statute does not pose a problem and there are sound policy reasons for permitting them to continue under the existing rules. The principal policy reason is that an expenditure test requires a careful auditing of the totality of the charity's receipts and disbursements, and this involves an undesirable involvement of the government in affairs of religious organizations.

In making specific recommendations, we are relying upon the legislative proposals made in 1974. These represent substantial progress in meeting the three criteria.

We recommend a bill which would spell out more specifically than present law the limits within which those public charities that elected to come within its provisions could participate in the legislative process. The bill would also be, in our opinion, more liberal than present law with respect to the rights of such charities to influence legislation.[46] On the other hand, the bill would be broader than present law in determining what constitutes influencing legislation.

1. Instead of the "substantial" test of present law, our proposal would be based upon specific expenditures of the charity.

Total expenditures to influence legislation ("lobbying") would be restricted to a percentage that would graduate downwards. For example: 20 percent of the first $500,000 of gross receipts; 15 percent of the next $500,000; 10 percent of the next $500,000; 5 percent of the next $500,000; 2 percent of all over $2,000,000.[47]

Grass-roots lobbying would be restricted to a percentage that would also graduate downwards. For example: 5 percent of the first $500,000; 4 percent of the next $500,000; 3 percent of the next $500,000; 2 percent of all over $1,500,000.[48]

Explanation: Early bills (including the one recommended by the American Bar Association) gave charities unlimited rights to lobby in matters of direct interest to them, to equate their position with that of trade associations and business organizations under section 162(e) of the Internal Revenue Code. However, this might make it possible for legislative-oriented organizations to expend their entire treasury on legislative efforts. The objective of the new law should be to allow public charities whose primary mission is functional, but which can not properly perform that mission without undertaking to influence legislation, to be able to do so, with enough "cushion" so that reasonable lobbying activities will not even come under serious question. The reverse graduation principle is adopted to prevent abuse of the privilege.

2. Public charities should be allowed to elect whether to come under this bill or remain under present law.[49] The separation of electing and non-electing charities should be so clear that no inference could be drawn that provisions of the new law were in any way declaratory of the law which would still govern the activities of non-electing charities.

Explanation: Church groups appear to be disturbed at the possibility of a "taint" that might result from definitions in the proposed legislation. Example: the definition of "influencing legislation." A complete separation, such as placing electing charities in a new 501(c) category similar in all other respects to present law, would perhaps solve the problem. Where the new law was specifically intended to be declaratory of present law (as might be true of some of the exclusions) the Committee Report could so state.

3. Conduct intended to influence legislation can be much broader than direct contacts of legislators. On the other hand, almost any statement issued with regard to a matter of public interest has a potential impact on legislation so that some way must be found to draw a line. The term "legislation" should be defined as including action by Congress, state legislators, or local bodies with legislative powers and should not extend to regulatory matters such as the issuance of regulations by the Treasury Department; and the term "action" would include the introduction, amendment, or defeat of acts, bills, and resolutions. It would encompass any attempt to influence any legislation, specifically including an attempt to affect the opinion of the general public. This broad definition of influencing legislation would be subject to specific exceptions:[50]

- Making available the results of nonpartisan analysis, study, or research.
- Providing technical advice, as requested, to governmental bodies.
- Activity with respect to the existence, powers and duties, and tax status of the charities, their members and contributors.
- Communication between the organization and its bona fide members with respect to legislative matters of direct interest.

With regard to the definition of "influencing legislation," the proposed definition contained in paragraph (f)(5) of section 1 of H.R. 13720 (attached hereto as an appendix) would encompass attempts to influence legislation not only by direct approaches to legislators but also efforts to affect the opinion of the general public or through communication with any governmental official or employee who may participate in the formulation of legislation. This would cover efforts to influence the Executive Department in the recommendations that it formulates for submission to Congress as well as meetings with Congressional staff members.

Explanation: The broad concept of influencing legislation is essential to a realistic test of total legislative activities. The first three exclusions are generally considered to be declaratory of present law. The fourth is critical to large public charities, and a good definition of "bona fide member" will prevent abuse.

4. An "affiliated organization" provision,[51] which would prevent evasion of the reverse graduation principle.

Explanation: Some "affiliated organizations" provision is in keeping with the principle of reverse graduation, which could otherwise be defeated by a multitude of similar organizations utilizing the relatively high starting brackets.

Appendix A

Text of H.R. 13720, H.R. 5095, and H.R. 12037

92d CONGRESS
2d Session

H. R. 13720

IN THE HOUSE OF REPRESENTATIVES

March 9, 1972

Mr. ULLMAN (for himself, Mr. CORMAN, Mr. BETTS, Mr. SCHNEEBELI, and Mr. CONABLE) introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To amend the Internal Revenue Code of 1954 with respect to lobbying by certain types of exempt organizations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. LOSS OF EXEMPT STATUS.

(a) Section 501 of the Internal Revenue Code of 1954 (relating to exemption from income tax) is amended by redesignating subsection (f) as subsection (g) and inserting after subsection (e) the following new subsection:

"(f) EXPENDITURES BY PUBLIC CHARITIES TO INFLUENCE LEGISLATION.–

"(1) GENERAL RULE.–In the case of an organization described in paragraph (2) that has elected under paragraph (3) to have this subsection apply, exemption from taxation under section 501(a) shall not be denied because a substantial part of the activities of such organization consists of carrying on propaganda or otherwise attempting to influence legislation, unless, with respect to the total of the amounts (including administrative expenses) paid by such organization (other than amounts chargeable to capital account) to accomplish one or more purposes described in section 170(c)(2)(B) (relating to religious, charitable, etc., purposes)–

"(A) amounts paid or incurred by such organizations during each taxable year to influence legislation (as defined in paragraph (5)) normally exceed 20 percent, or

"(B) amounts paid or incurred by such organization during each taxable year to influence legislation (within the meaning of paragraph (5)(A)) normally exceed 5 percent.

"(2) ORGANIZATIONS TO WHICH THIS PROVISION APPLIES.–An election under paragraph (3) to have this subsection apply may be made by any organization described in–

"(A) section 170(b)(1)(A)(i) (relating to churches and conventions or associations of churches),

"(B) section 170(b)(1)(A)(ii) (relating to educational institutions),

"(C) section 170(b)(1)(A)(iii) (relating to hospitals and medical research organizations),

"(D) section 170(b)(1)(A)(iv) (relating to organizations supporting government schools),

"(E) section 170(b)(1)(A)(v) (relating to governmental units),

"(F) section 170(b0(1)(A)(vi) (relating to organizations publicly supported by charitable contributions),

"(G) section 509(a)(2) (relating to organizations publicly supported by admissions, sales, etc.), or

"(H) section 509(a)(3) (relating to organizations supporting certain types of public charities), except that for purposes of this subsection, section 509(a)(3) shall be applied without regard to the last sentence of section 509(a).

"(3) ELECTIONS.–Any organization described in paragraph (2) may elect, in such manner and at such time as the Secretary or his delegate may prescribe, to have the provisions of this subsection apply to such organization.

"(4) YEARS FOR WHICH ELECTION IS EFFECTIVE.–An election by an organization under paragraph (3) shall be effective for all taxable years of such organization which–

"(A) end after the date the election is made, and

"(B) begin before the earlier of (i) the date the election is revoked (under regulations prescribed by the Secretary or his delegate) or (ii) the date such organization ceases to be described in paragraph (2).

"(5) INFLUENCING LEGISLATION.–For purposes of this subsection the term 'influencing legislation,' with regard to an organization, means–

"(A) any attempt (other than an attempt described in subparagraph (B) or (C)) to influence any legislation (including an attempt to affect the opinion of the general public or any segment thereof),

"(B) any attempt to influence legislation, on a matter which directly affects any purpose for which such organization is organized and operated, through communication with any member or employee of a legislative body, or with any other government official or employee who may participate in the formulation of the legislation, and

"(C) any attempt to influence legislation, on a matter which directly affects any purpose for which such organization is organized and operated through direct communication of information between such organization and one or more of its members, other than through making available the results of nonpartisan analysis, study, or research; the term 'influencing legislation', with regard to an organization, does not include the providing of technical advice or assistance to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision, as the case may be, nor does it include an appearance before, or communication to, any legislative body with respect to a possible decision of such body which might affect the existence of the organization, its powers and duties, its tax-exempt status, or the deduction of contributions to such organization; the term 'legislation' includes action with respect to acts, bills, resolutions, or similar items by the Congress, any State legislature, any local council, or similar governing body, by any similar governing body outside the United States, or by the public in a referendum, initiative, constitutional amendment, or similar procedure; the term 'action' is limited to the introduction, amendment, enactment, defeat, or repeal of acts, bills, resolutions, or similar items."

(b) Section 501(c)(3) of such Code is amended by striking out "no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation," and inserting in lieu thereof "no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation (except as otherwise provided in subsection (f)),".

SEC. 2. DISALLOWANCE OF DEDUCTION FOR CONTRIBUTIONS TO INFLUENCE LEGISLATION.

(a) Section 170(f) of such Code (relating to disallowance of charitable contribution deductions in certain cases) is amended by adding at the end thereof the following new paragraph:

"(7) CONTRIBUTIONS TO INFLUENCE LEGISLATION.–No deduction shall be allowed under this section for a contribution for the use of and organization described in subsection (c) if the contribution is made for the purpose of influencing legislation (as defined in section 501(f)(5))."

SEC. 3. CONFORMING AMENDMENTS.

(a)(1) The following sections of such Code are amended by striking out "no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation," whereever it appears therein and inserting in lieu thereof "no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation (within the meaning of section 501(c)(3)),":

(A) Section 170(c)(2)(D) (relating to the definition of charitable contributions);
(B) Section 2055(a)(2) relating to transfers for public, charitable, and religious uses);
(C) Section 2106(a)(2)(A)(ii) (relating to transfers for public, charitable, and religious uses);
(D) Section 2522(a)(2) (relating to charitable and similar gifts of citizens or residents); and
(E) Section 2522(b)(2) (relating to charitable and similar gifts of nonresidents).

(2) Sections 2055(a)(3) and 2106(a)(3) of such Code (relating to transfers for public, charitable, and religious uses) are each amended by striking out "no substantial part of the activities of such trustee or trustees, or of such fraternal society, order, or association, is carrying on propaganda, or otherwise attempting, to influence legislation," wherever it appears therein and inserting in lieu thereof "no substantial part of the activities of such trustee or trustees, or of such fraternal society, order, or association, is carrying on propaganda or otherwise attempting to influence legislation (within the meaning of section 501(c)(3)),".

(b) Sections 2055(e) and 2522(c) of such Code (relating to disallowance of charitable contributions in certain cases) are each amended by adding at the end thereof the following new paragraph:

> "(3) CONTRIBUTIONS TO INFLUENCE LEGISLATION.—No deduction shall be allowed under this section for a contribution for the use of an organization described in section 170 if the contribution is made for the purpose of influencing legislation (as defined in section 501(f)(5))."

SEC. 4. EFFECTIVE DATE.

The amendments made by this Act shall be applicable to taxable years beginning after the date of the enactment thereof and to estates of decedents dying after the date of the enactment thereof.

93d CONGRESS
1st Session

H. R. 5095

IN THE HOUSE OF REPRESENTATIVES

March 1, 1973

Mr. ULLMAN (for himself, Mr. SCHNEEBELI, Mr. CORMAN, and Mr. GREEN of Pennsylvania) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954 with respect to lobbying by certain types of exempt organizations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. LOSS OF EXEMPT STATUS.

(a) Section 501 of the Internal Revenue Code of 1954 (relating to exemption from income tax) is amended by redesignating subsection (f) as subsection (g) and inserting after subsection (e) the following new subsection:

"(f) EXPENDITURES BY PUBLIC CHARITIES TO INFLUENCE LEGISLATION.—

"(1) GENERAL RULE.—In the case of an organization described in paragraph (2) that has elected under paragraph (3) to have this subsection apply, exemption from taxation under section 501(a) shall not be denied because of substantial part of the activities of such organization consists of carrying on propaganda or otherwise attempting to influence legislation, unless—

"(A)(i) with respect to the total of the amounts (including administrative expenses) paid by such organization (other than amounts chargeable to capital account) to accomplish one or more purposes described in section 170(c)(2)(B) (relating to religious, charitable, educational, etc., purposes),

"(ii) amounts paid or incurred by such organization during each taxable year to influence legislation on a matter which directly affects any purpose for which such organization is organized and operated, through communication with any member or employee of a legislative body or with any other government official or employee who may participate in the formulation of the legislation normally exceeds, or

"(iii) the lesser of $500,000 or the sum of 15 percent of the first $200,000 of the amounts described in clause (i),

10 percent of the next $200,000 of the amounts described in clause (i), 5 percent of the next $200,000 of the amounts described in clause (i), and 1 percent of the excess over $600,000 of the amounts described in clause (i), or

"(B) a significant portion of the activities of such organization (other than activities the expenditures for which are described in subparagraph (A) (ii)) consists of carrying on propaganda or otherwise attempting to influence legislation.

"(2) ORGANIZATIONS TO WHICH THIS PROVISION APPLIES.—An election under paragraph (3) to have this subsection apply may be made by any organization described in—

"(A) section 170(b)(1)(A)(ii) (relating to educational institutions),

"(B) section 170(b)(1)(A)(iii) (relating to hospitals and medical research organizations),

"(C) section 170(b)(1)(A)(iv) (relating to organizations supporting government schools),

"(D) section 170(b)(1)(A)(v) (relating to governmental units), or

"(E) (i) section 170(b)(1)(A)(vi) (relating to organizations publicly supported by charitable contributions), section 509(a)(2) (relating to organizations publicly supported by admissions, sales, etc.), or section 509(a)(3) (relating to organizations supporting certain types of public charities), (except that for purposes of this subsection, section 509(a)(3) shall be applied without regard to the last sentence of section 509(a)),

"(ii) which is neither described in section 170(b)(1)(A) (relating to churches and conventions or associations of churches) nor is an integrated auxiliary of a church.

"(3) ELECTIONS.—Any organization described in paragraph (2) may elect, in such manner and at such time as the Secretary or his delegate may prescribe, to have the provisions of this subsection apply to such organization.

"(4) YEARS FOR WHICH ELECTION IS EFFECTIVE.—An election by an organization under paragraph (3) shall be effective for all taxable years of such organization which—

"(A) end after the date the election is made, and

"(B) begin before the earlier of (i) the date the election is revoked by such organization (under regulations prescribed by the Secretary or his delegate) or (ii) the date such organization ceases to be described in paragraph (2).

"(5) INFLUENCING LEGISLATION.—For purposes of this subsection—

"(A) the term 'influencing legislation', with regard to an organization, does not include—

"(i) making available the results of nonpartisan analysis, study, or research,

"(ii) providing of technical advice or assistance to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision, as the case may be, and

"(iii) appearances before, or communications to, any legislative body with respect to a possible decision of such body which might affect the existence of the organization, its powers and duties, its tax-exempt status, or the deduction of contributions to such organization;

"(B) the term 'legislation' includes action with respect to acts, bills, resolutions, or similar items by the Congress, any State legislature, any local council, or similar governing body, by any similar governing body outside the United States, or by the public in a referendum initiative, constitutional amendment, or similar procedure;

"(C) the term 'action' is limited to the introduction, amendment, enactment, defeat, or repeal of acts, bills, resolutions, or similar items; and

"(D) expenditures for entertainment shall not be treated as amounts described in paragraph (1)(A) but, to the extent such entertainment was an activity engaged in for the purpose of propaganda or otherwise attempting to influence legislation (or was engaged in in connection with an activity described in subparagraph (A)), such entertainment shall be regarded as an activity to which paragraph (1)(B) applies.

"(6) AFFILIATED ORGANIZATIONS.—If for a taxable year two or more organizations are effectively controlled (directly or indirectly) by the same person or persons and an election under paragraph (3) is effective for at least one such organization for such year, then such organizations shall be treated as constituting one organization in applying paragraph (1)(A) (relating to expenditures limits) and if the expenditure limits of that paragraph are exceeded, such organizations shall be treated as constituting one organization for purposes of applying subsections (a) and (c)(3), and this subsection."

(b) Section 501(c)(3) of such Code is amended by striking out "no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation," and inserting in lieu thereof "no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation (except as otherwise provided in subsection (f)),".

SEC. 2. DISALLOWANCE OF DEDUCTION FOR CONTRIBUTIONS TO INFLUENCE LEGISLATION.

Section 170(f) of such Code (relating to disallowance of charitable contribution deductions in certain cases) is amended by adding at the end thereof the following new paragraph:

"(7) CONTRIBUTIONS TO INFLUENCE LEGISLATION.—No deduction shall be allowed under this section for an expenditure on behalf of an organization described in subsection (c) if the contribution is made for the purpose of influencing legislation."

SEC. 3. TERMINATION OF CHARITABLE DONEE STATUS.

(a) Part I of subchapter F of chapter 1 of such Code (relating to general rules as to exempt organizations) is amended by adding at the end thereof the following new section:

"SEC. 504. TERMINATION OF EXEMPT STATUS.

"(a) GENERAL RULE.—There is hereby imposed on each organization which ceases to be described in section 501(c)(3), a tax equal to the lesser of—

"(1) 30 percent of the value of the net assets of such organization, or

"(2) the amount which the organization substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the exempt status of such organization.

"(b) AGGREGATE TAX BENEFIT.—For purposes of subsection (a), the aggregate tax benefit resulting from the exempt status of an organization is the sum of—

"(1) the aggregate increase in tax under chapters 1, 11, and 12 (or the corresponding provisions of prior law) which would have been imposed with respect to all contributors to the organization if deductions for all contributions made by such contributors to the organization after May 10, 1914, had been disallowed,

"(2) the aggregate increases in tax under chapter 1 (or the corresponding provisions of prior law) which would have been imposed with respect to the income of the organization for taxable years beginning after December 31, 1913, if (A) it had not been exempt from tax under section 501(a) (or the corresponding provisions of prior law), and (B) in the case of a trust, deductions under section 642(c) (or the corresponding provisions of prior law) had been limited to 20 percent of the taxable income of the trust (computed without the benefit of section 642(c) but with the benefit of section 170(b)(1)(A)), and

"(3) interest on the increases in tax determined under paragraphs (1) and (2) from the first date on which each such increase would have been due and payable to the date on which the organization ceases to be described in section 501(c)(3).

Paragraph (2) shall not apply to an organization that is exempt under section 501(a) and is described in section 501(c) (other than paragraph (3) thereof).

"(c) SPECIAL RULES.—

"(1) For purposes of this section, the determination as to whether and to what extent there would have been any increase in tax shall be made in accordance with regulations prescribed by the Secretary or his delegate.

"(2) For purposes of subsection (a), the value of the net assets shall be determined at whichever time such value is higher: (A) the first day on which action is taken by the organization which culminates in its ceasing to be described in section 501(c)(3), or (B) the date on which it ceases to be described in section 501(c)(3).

"(3) The Secretary or his delegate may abate the unpaid portion of the assessment of any tax imposed by subsection (a), or any liability thereof, if—

"(A) the organization distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months and none of which is effectively controlled (directly or indirectly) by the same person or persons that control the distributing organization, or

"(B) following the notification prescribed in section 6104(c) to the appropriate State officer, such State officer within one year notifies the Secretary or his delegate, in such manner as the Secretary or his delegate may by regulations prescribe, that corrective action has been initiated pursuant to State law to insure that the assets of the organization are preserved for such charitable or other purposes specified in section 501(c)(3) as may be ordered or approved by a court of competent jurisdiction, and upon completion of the corrective action, the Secretary or his delegate receives certification from the appropriate State officer that such action has resulted in such preservation of assets.

"(4) For purposes of this subsection, in the case of a transfer of assets of any organization to another organization pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee organization shall not be treated as a newly created organization.

"(5) For purposes of determining liability for the tax imposed by subsection (a) in the case of assets transferred by the organization, such tax shall be deemed to have been imposed on the first day on which action is taken by the organization which culminates in its ceasing to be described in section 501(c)(3).

"(6) No tax shall be imposed on an organization by subsection (a) on account of the same actions taken by such organization which give rise to a tax imposed on such organization by section 507, except to the extent that the tax determined by subsection (a) exceeds the tax imposed by section 507."

(b) The table of sections for such part is amended by adding at the end thereof the following new item:

"Sec. 504. Termination of exempt status."

SEC. 4. ELECTIONEERING BY CIVIC LEAGUES, ETC.

Section 501(c)(4) of such Code (relating to exempt status of civic leagues and certain kinds of local associations of employees) is amended by striking out "recreation purposes." and inserting in lieu thereof "recreation purposes; but only if such civic league or organization, or local association of employees does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office."

SEC. 5. CONFORMING AMENDMENTS.

(a)(1) The following sections of such Code are amended by striking out "no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation," whenever it appears therein and inserting in lieu thereof "no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation (within the meaning of section 501(c)(3)),":

(A) Section 170(c)(2)(D) (relating to the definition of charitable contributions);

(B) Section 2055(a)(2) (relating to transfers for public, charitable, and religious uses);

(C) Section 2106(a)(2)(A)(ii) (relating to transfers for public, charitable, and religious uses);

(D) Section 2522(a)(2) (relating to charitable and similar gifts of citizens or residents); and

(E) Section 2522(b)(2) (relating to charitable and similar gifts of nonresidents).

(2) Sections 2055(a)(3) and 2106(a)(3) of such Code (relating to transfers for public, charitable, and religious uses) are each amended by striking out "no substantial part of the activities of such trustee or trustees, or of such fraternal society, order, or association, is carrying on propaganda, or otherwise attempting to influence legislation," wherever it appears therein and inserting in lieu thereof "no substantial part of the activities of such trustee and trustees, or of such fraternal society, order, or association, is carrying on propaganda or otherwise attempting to

influence legislation (within the meaning of section 501(c)(3)).".

(b) Sections 2055(e) and 2522(c) of such Code (relating to disallowance of charitable contributions in certain cases) are each amended by adding at the end thereof the following new paragraph:

"(3) CONTRIBUTIONS TO INFLUENCE LEGISLATION.—No deduction shall be allowed under this section for an expenditure on behalf of an organization described in section 170 if the contribution is made for the purpose of influencing legislation."

(c) Section 6104(c)(1)(B) of such Code (relating to notification to State officials) is amended by striking out "section 507" and inserting in lieu thereof "section 504 or 507".

(d) Section 6214(c) of such Code (relating to determinations by the Tax Court) is amended—

(1) by striking out in the heading thereof "Section 507" and inserting in lieu thereof "Section 504 or 507" and

(2) by striking out in the text thereof "section 507" and inserting in lieu thereof "section 504 or 507".

(e) Section 6501(c) of such Code (relating to limitations on assessment and collection) is amended by adding at the end thereof the following new paragraph:

"(8) TERMINATION OF EXEMPT STATUS.—In the case of a tax on ceasing to be described in section 501(c)(3), such tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time."

(f) Section 6503(h) of such Code (relating to suspension of limitations period pending correction) is amended by striking out "section 507" and "section 507(g)(2)" and inserting in lieu thereof "section 504 or 507" and "section 504(c)(3) or 507(g)(2)", respectively.

SEC. 6. EFFECTIVE DATE.

(a) Except as otherwise provided in subsection (b), the amendments made by this Act shall be applicable to taxable years beginning after December 31, 1973, and before January 1, 1979, and to estates of decedents dying after December 31, 1973, and before January 1, 1979.

(b) The amendments made by section 3 of this Act shall apply to any organization that—

(1) at any time after the date of enactment of this Act and before January 1, 1979, is exempt from taxation under section 501(a) as an organization described in section 501(c)(3), and

(2) at any time thereafter, and before January 1, 1979, ceases to be exempt from taxation under section 501(a) as an organization described in section 501 (c)(3).

93d CONGRESS
1st Session

H. R. 12037

IN THE HOUSE OF REPRESENTATIVES

December 19, 1973

Mr. CONABLE (for himself, Mr. ULLMAN, Mr. SCHNEEBELI, Mr. CORMAN, Mr. GIBBONS, and Mr. PETTIS) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954 with respect to lobbying by certain types of exempt organizations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. LOSS OF EXEMPT STATUS.

(a) Section 501 of the Internal Revenue Code of 1954 (relating to exemption from income tax) is amended by redesignating subsection (f) as subsection (g) and inserting after subsection (e) the following new subsection:

"(f) EXPENDITURES BY PUBLIC CHARITIES TO INFLUENCE LEGISLATION.–

"(1) GENERAL RULE.–In the case of an organization described in paragraph (2) that has elected under paragraph (3) to have this subsection apply, exemption from taxation under section 501(a) shall not be denied because of substantial part of the activities of such organization consists of carrying on propaganda or otherwise attempting to influence legislation, unless–

"(A)(i) with respect to the total of the amounts (including administrative expenses) paid by such organization (other than amounts chargeable to capital account) to accomplish one or more purposes described in section 170(c)(2)(B) (relating to religious, charitable, educational, etc., purposes).

"(ii) amounts paid or incurred by such organization during each taxable year to influence legislation on a matter which directly affects any purpose for which such organization is organized and operated, through communication with any member or employee of a legislative body or with any other government official or employee who may participate in the formulation of the legislation, normally exceed

"(iii) the lesser of $500,000 or the sum of 15 percent of the first $200,000 of the amounts described in clause (i), 10 percent of the next $200,000 of the amounts described in clause (i), 5 percent of the next $200,000 of the amounts described in clause (i), and 1 percent of the excess over $600,000 of the amounts described in clause (i), or

"(B) a significant portion of the activities of such organization (other than activities the expenditures for which are described in subparagraph (A)(ii)) consists of carrying on propaganda or otherwise attempting to influence legislation.

"(2) ORGANIZATIONS TO WHICH THIS PROVISION APPLIES.–An election under paragraph (3) to have this subsection apply may be made by any organization described in–

"(A) section 170(b)(1)(A)(ii) (relating to educational institutions),

"(B) section 170(b)(1)(A)(iii) (relating to hospitals and medical research organizations),

"(C) section 170(b)(1)(A)(iv) (relating to organizations supporting government schools),

"(D) section 170(b)(1)(A)(v) (relating to governmental units), or

"(E)(i) section 170(b)(1)(A)(vi) (relating to organizations publicly supported by charitable contributions), section 509(a)(2) (relating to organizations publicly supported by admissions, sales, etc.), or section 509(a)(3) (relating to organizations supporting certain types of public charities) (except that for purposes of this subsection, section 509(a)(3) shall be applied without regard to the last sentence of section 509(a)),

"(ii) which is neither described in section 170(b)(1)(A)(i) (relating to churches and conventions or associations of churches) nor is an integrated auxiliary of a church.

"(3) ELECTIONS.–Any organization described in paragraph (2) may elect, in such manner and at such time as the Secretary or his delegate may prescribe, to have the provisions of this subsection apply to such organization.

"(4) YEARS FOR WHICH ELECTION IS EFFECTIVE.–An election by an organization under paragraph (3) shall be effective for all taxable years of such organization which–

"(A) end after the date the election is made, and

"(B) begin before the earlier of (i) the date the election is revoked by such organization (under regulations prescribed by the Secretary or his delegate) or (ii) the date such organization ceases to be described in paragraph (2).

"(5) INFLUENCING LEGISLATION.–For purposes of this subsection–

"(A) the term 'influencing legislation', with regard to an organization, does not include–

"(i) making available the results of nonpartisan analysis, study, or research,

"(ii) providing of technical advice or assistance to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision, as the case may be,

"(iii) appearances before, or communications to, any legislative body with respect to a possible decision of such body which might affect the existence of the organization, its powers and duties, its tax-exempt status, the deduction of contributions to the organization, or such attributes of members of the organization; and "(iv) communication of information between the organization and its bona fide members with respect to legislation or proposed legislation of direct interest to the organization and such members;

"(B) the term 'legislation' includes action with respect to Acts, bills, resolutions, or similar items by the Congress, and State legislature, any local council, or similar governing body, by any similar governing body outside the United States, or by the public in a referendum, initiative, constitutional amendment, or similar procedure;

"(C) the term 'action' is limited to the introduction, amendment, enactment, defeat, or repeal of acts, bills, resolutions, or similar items; and

"(D) expenditures for entertainment shall not be treated as amounts described in paragraph (1)(A) but, to the extent such entertainment was an activity engaged in for the purpose of propaganda or otherwise attempting to influence legislation (or was engaged in connection with an activity described in subparagraph (A)), such entertainment shall be regarded as an activity to which paragraph (1)(B) applies.

"(6) AFFILIATED ORGANIZATIONS.–If for a taxable year two or more organizations are effectively controlled (directly or indirectly) by the same person or persons and an election under paragraph (3) is effective for at least one such organization for such year, then such organizations shall be treated as constituting one organization in applying paragraph (1)(A) (relating to expenditures limits) and if the expenditure limits of that paragraph are exceeded, such organizations shall be treated as constituting one organization for purposes of applying subsections (a) and (c)(3), and this subsection."

(b) Section 501(c)(3) of such Code is amended by striking out "no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation," and inserting in lieu thereof "no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation (except as otherwise provided in subsection (f)),".

SEC. 2. DISALLOWANCE OF DEDUCTION FOR CONTRIBUTIONS TO INFLUENCE LEGISLATION.

Section 170(f) of such Code (relating to disallowance of charitable contribution deductions in certain cases) is amended by adding at the end thereof the following new paragraph:

"(7) CONTRIBUTIONS TO INFLUENCE LEGISLATION.–No deduction shall be allowed under this section for an expenditure on behalf of an organization described in subsection (c) if the contribution is made for the purpose of influencing legislation (defined in accordance with section 501(f)(5) (A), (B), and (C))."

SEC. 3. CONFORMING AMENDMENTS.

(a)(1) The following sections of such Code are amended by striking out "no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation," whenever it appears therein and inserting in lieu thereof "which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation,":

(A) Section 170(c)(2)(D) (relating to the definition of charitable contributions);

(B) Section 2055(a)(2) (relating to transfers for public, charitable, and religious uses);

(C) Section 2106(a)(2)(A)(ii) (relating to transfers for public, charitable, and religious uses);

(D) Section 2522(a)(2) (relating to charitable and similar gifts of citizens or residents); and

(E) Section 2522(b)(2) (relating to charitable and similar gifts of nonresidents).

(2) Sections 2055(a)(3) and 2106(a)(2) of such Code (relating to transfers for public, charitable, and religious uses) are each amended by striking out "no substantial part of the activities of such trustee or trustees, or of such fraternal society, order, or association, is carrying on propaganda, or otherwise attempting, to influence legislation," wherever it appears therein and inserting at the end of each such section "and such trust, fraternal society, order, or association would not be disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation,".

(b) Sections 2055(e) and 2522(c) of such Code (relating to disallowance of charitable contributions in certain cases) are each amended by adding at the end thereof the following new paragraph:

"(3) CONTRIBUTIONS TO INFLUENCE LEGISLATION.–No deduction shall be allowed under this section for an expenditure on behalf of an organization described in section 170 if the contribution is made for the purpose of influencing legislation (defined in accordance with section 501(f)(5) (A), (B), and (C)."

SEC. 4. EFFECTIVE DATE.

The amendments made by this Act shall be applicable to taxable years beginning after December 31, 1973, and to estates of decedents dying after December 31, 1973.

Appendix B

Legislative Activities of Private Foundations

Introduction

A private foundation by definition must qualify as an organization described in section 501(c)(3). Thus the prior discussion concerning what constitutes a "substantial" part of its income is relevant. In theory, a private foundation can lose its section 501(c)(3) status just as readily as any other organization if a "substantial" part of its activities were the influencing of legislation. In practice, there have been only isolated instances of private foundation interest in legislation. This relative disinterest didn't equate with total disinterest and Congress made certain by restrictions added in the 1969 Tax Reform Act that foundations would not be tempted.

The 1969 act introduced several new sections relevant to the conduct of legislative activities by private foundations in addition to those contained in section 501(c)(3). Most directly in point is section 4945 which provides a tax on "taxable expenditures" of 10 percent of the amount expended plus a tax on foundation management of 2.5 percent if the expenditure was voluntary, conscious, and intentional. Also relevant in determining the consequences of legislative expenditures are the provisions in section 4940 for the imposition of a 4 percent tax on net investment income. Presumably, net investment income is to be determined after deduction of some expenses by analogy to section 162(e). Third, section 4942 imposes a tax on failure to distribute income. The tax (at an initial level of 15 percent) is imposed on the difference between the "distributable amount" and the "qualifying distributions." The latter term includes both charitable grants and direct expenditures of the foundation for charitable purposes. Thus, legislative activities could easily arise as an amount paid to accomplish a purpose described in section 170(c)(2)(B).

The interplay of the sections produces some rather difficult distinctions. For example, a private foundation can properly seek an amendment to chapter 42 to ease the strictures on annual distributions. This would permit it to adopt more flexible plans that would lead to a more efficient discharge of its charitable purposes. On the other hand, the organization could not lobby for additional appropriations for medical research although this might be the best way to fulfill the section 170 objective. Turning to sections 4940 and 4942, such an expense would seem to be a qualifying distribution since it was paid to accomplish a section 170 objective as distinguished from the management of its investment portfolio. This analysis reflects the fact that a charity actually has two levels of activity: (1) the conduct of charitable activities which are the exclusive purpose for which it is organized and operated, to paraphrase section 501(c)(3); and (2) raising the funds whether through soliciting donations or managing endowment so that it is possible to carry on the charitable activities which are its ultimate purpose.

In general, an expenditure that analogizes to a business expense reduces the foundation's income that is subject to the 4 percent tax imposed by section 4940; an expenditure to accomplish its charitable purpose is treated as a qualifying distribution. The Regulations point out that some expenditures will be allocated so that a portion is in one category and the balance in the other.

The provision in section 4940 is that the tax is imposed on the "net investment income" of the foundation. This is further defined as permitting deduction for "all the ordinary and necessary expenses paid or incurred for the production or collection of gross investment income, or for the management, conservation, or maintenance of property held for the production of such income." (Section 4940(c)(3)(A).) Thus, the reference to the term "ordinary and necessary" suggests a relationship to section 162, in spite of the fact that a private foundation does not have a business motive of the sort associated with section 162. It logically follows that any legislative activities of the sort that would be an appropriate deduction when incurred by a business would be an appropriate deduction in computing the 4 percent tax. On the other hand, legislative activity that is concerned with the performance of the charitable function would not come within this scope. It could be argued that expenses relating to the disposition of the assets of the foundation qualifies as a deduction as permitted by section 4940, but other types of legislative activities permitted by section 4945 would seem to involve the performance of its charitable function rather than the production of its income.

Section 4942 imposes a tax on failure to distribute income and defines the "distributable amount" as "the minimum investment return or the adjusted net income reduced by taxes imposed under Section 4940" and less "qualifying distributions." (Section 4942(c) and (g).) This term is in turn defined as "any amount (including administrative expenses) paid to accomplish one or more purposes described in Section 170(c)2b . . . ." The Regulations under section 4942 are not very helpful in distinguishing between expenses that are deductible in arriving at the tax under section 4940 and those that are deemed qualifying distributions under section 4942. The Regulations refer to the expenses described in section 4942 as including administrative expenses and items of overhead attributable to activities of employees directly involved in the grants program or other charitable activity. It does not specifically refer to legislative activities. Regulations 53.4942 (a)-3 (a)-8, Example 1, assumes an allocation (presumably between sections 4940 and 4942) without specifying the nature of the activities or otherwise being helpful.

An instance of an expense of a dual nature (as distinguished from an allocable expense) would be activities relating to disposition of excess business holdings, since such activity relates to a duty of the foundation (this is permitted by section 4945(e)), to the production of income (since the sale or retention of income producing assets is clearly an investment expense), and also to its charitable functions, since the disposition of the asset may well jeopardize its ability to conduct future charitable programs as anticipated. However, the Regulations of section 4940 make no reference to legislative activities. Just as an argument can be made that some expenses qualify, for purposes of both section 4940 and section 4942, an argument could be made that some expenses do not fall into either basket, although they are not taxable expenditures for purposes of section 4945.

From the point of view of practitioners required to advise foundations, it would be most helpful to have an express statement with regard to expenditures. The most reasonable one (and the one that seems to be consistent with published Service positions and the informal discussions with the authors) is that all expenditures that are not taxable expenditures constitute either a deduction under section 4940 or a qualifying distribution under section 4942, but do not qualify for both. The only logical exception to such a rule would be items such as sales expenses that would reduce the amount realized when an investment asset is disposed of.

Criticism of Statute

A beginning point in any consideration of the restrictions on private foundations must start with the dubious constitutional basis upon which the taxes rest. Penalties are imposed that have nothing to do with either the generation of the income of the foundation or the retention of the income by the charitable organization. Thus, the pattern of penalties that is inconsistent with those outside the private foundation area and with the general structure of the tax law suggests that Congress was in a state of panic when it enacted the 1969 legislation and that the whole sanctions structure is suspect. (See Troyer, "Charities, Law-Making and the Constitution: The Validity of the Restrictions on Influencing Legislation," 31 N.Y.U. Inst. on Fed. Tax 1415 (1973).)

Private foundations have never been prominent in the legislative field, so the authors believe the restrictions imposed hamper foundation legislative activity in only isolated cases. Nevertheless, the situation that Senator Hartke used in a recent speech (address to OMI meeting) concerned two health foundations with similar purposes. When a bill was before Congress, one worked to get appropriations to expand research and one did not. The Senator applauded the former and criticized the latter. Presumably, the foundations were public charities and outside section 4945 but the public-private distinction seems completely unrelated to the ability to seek funds to further research. This is just one more way that the second-class citizenship of private foundations is a potential hindrance.

The second problem is the difficulty of determining which expenditures are deductible in computing net investment income and which are qualifying distributions. If a good faith error is made, a tax will be imposed regardless of the bona fides of the allocation. A correction without penalty is provided when assets are valued erroneously but not when a disbursement is erroneously allocated. In the case of income tax deficiencies an error that reflects neither fraud nor negligence does not generate a penalty. Even a personal holding company (certainly not a type of entity favored by the tax laws) can declare a deficiency dividend to correct a mistake. Thus to impose a penalty tax when an action is taken on advice of counsel (see Regulation §53.4945-1(a)(2)(vi)) is inconsistent with the general tax pattern.

Finally, counsel faced with advising private foundations find that the Regulations leave many unanswered questions and there are few published rulings to fill the gaps. This is particularly troublesome when the consequences of being wrong are so onerous.

Recommendations

Congress has expressed the basic policy that private foundations should remain out of the legislative area with the exceptions (elaborately defined in the statute) of nonpartisan research and self-preservation. (See Section 4945.) Numerous new and difficult distinctions are presented and the imposition of penalty taxes for good faith errors seems unjustified. At a minimum, the Treasury should explain its views on the distinctions in much greater detail, and preferably the rule relating to errors in valuation should be expanded to cover all good-faith errors.

While other charities may engage in much broader legislative activities and social welfare organizations (described in section 501(c)(4)) have no limitations on legislative activities, a distinction may be justified by the "private" nature of the private foundation. Thus the proper role of the Treasury is to clarify the distinction, and the proper audit function is to correct good-faith errors – not to impose penalties when there is no intent to avoid the broad policies of the statute. Thus the recommendation is to retain the pattern of the statute but to strip it of its obscurity and to remove the penalty on good-faith errors that are corrected.

Footnotes

1. Identical language prohibiting charitable organizations from engaging in substantial lobbying activities is also contained in sections 170(c)(2)(D), 2055(a)(2), 2106(a)(2)(A)(ii), and 2522(a)(2), which sections permit income, estate, and gift tax deductions for charitable contributions. These sections also fail to provide a definition of substantial activities.

2. 22 T.C. 1091 (1954), *acq.* 1954-2 C.B. 4.

3. 227 F.2d 907 (6th Cir. 1955), rev'g 22 T.C. 671.

4. 470 F.2d 849, 855 (10th Cir. 1972), *cert. denied*, 414 U.S. 864 (1973).

5. 148 Ct. Cl. 561, 180 F. Supp. 379 (1960).

6. 195 F.2d 948 (8th Cir., 1952).

7. Supra note 4.

8. Supra note 2, at 1099.

9. 314 U.S. 326 (1941).

10. 358 U.S. 498 (1959).

11. S. Rep. No. 1881, 87th Cong., 2d Sess. 22 (1962).

12. *Seasongood v. Commissioner*, supra note 4, and discussion in text.

13. The Service later administratively withdrew its position.

14. Statement of Mortimer M. Caplin, Washington, D.C., in *Hearings Before the Committee on Ways and Means on H.R. 13720 to Amend the Internal Revenue Code with Respect to Lobbying by Certain Types of Exempt Organizations*, 92nd Cong., 2d Sess. 40 (1972) [hereinafter cited as *Hearings*].

15. Under present law an organization faced with loss of its 501(c)(3) status cannot obtain immediate judicial review of an adverse determination by the Service. Rather, it must wait until

it receives a deficiency notice (or a denial of a claim for refund) and then contest its tax liability. The Ways and Means Committee has tentatively agreed (Press Release No. 6, May 20, 1974) to provide a procedure for declaratory judgment in the Tax Court as to the tax exempt status of an organization. This would make the problem less critical, but would still not provide a complete solution.

16. Support for the proposition that a vague and uncertain standard is inappropriate where the penalty for violation of the standard is loss of exemption is found in the legislative history of section 4942 of the Code. Previously vague standards were made more definite, and the penalties were changed. The Treasury Department Report to the House Ways and Means Committee recommended more specific guidelines in the area of unreasonable accumulation of income, noting: "Fourteen years of experience have indicated that in this context standards such as 'unreasonable,' 'substantial,' and 'jeopardize' are inadequate as well as difficult and expensive to administer. The lack of definite rules leads to uncertainty, not only in the minds of those charged with the responsibility of administering this provision, but also in the minds of foundation managers who are aware that departure from the uncertain path of 'reasonable' accumulations may result in loss of exemption." The Ways and Means Committee Report explaining the new provisions stated: "Although a number of court cases have begun to set guidelines as to the circumstances under which an accumulation becomes unreasonable, in many cases the determination is essentially subjective. Moreover . . . it frequently happens that the only available sanction (loss of exempt status) either is largely ineffective or else is unduly harsh." [H.R. Rep. No. 413, Pt. 1, 91st Cong., 1st Sess., 25 (1969)]. Identical language is contained in the Senate Finance Committee Report [S. Rep. No. 552, 91st Cong., 1st Sess. 35 (1969)].

17. See, Statement of Stanley S. Weithorn, counsel, National Assembly for Social Policy and Development in *Hearings*, supra note 14, at 60.

18. Section 162(e)(1) permits deductions with respect to direct lobbying activities by the business and communication of information between the business and any organization of which it is a member. Such organizations themselves are often classified as tax exempt under section 501(c)(6) of the Code.

19. Supra page 2919.

20. This inconsistency has become increasingly apparent as the various administrative agencies have been granted broader regulatory authority by Congress.

21. A more detailed discussion of recent legislative proposals is presented infra page 25, et seq.

22. Remarks of Senator Muskie, 117 Cong. Rec. 8517 (1971).

23. *Hearings Before the Committee on Ways and Means on the Subject of General Tax Reform*, 93d Cong., 1st Sess., 1496 (1973).

24. Statement of Elvis J. Stahr, chairman, Coalition of Concerned Charities, *Hearings*, supra note 23, at 1483.

25. H./Rept. No. 1860, 75th Cong., 3d Sess. (1938).

26. Indeed, it was suggested at one point that lobbying rights of charities be limited to areas of "confrontation" with business. See *Hearings*, supra note 14, at 11. However, this suggestion was not pressed and has not been incorporated in any proposed legislation.

27. See Statement of Edwin S. Cohen, in *Hearings*, supra note 14, at 8.

28. For example, see section 1561 of the Code, limiting multiple surtax exemptions and accumulated earnings credits in the case of component members of a controlled group of corporations.

29. See, for example, H.R. 5095, 93d Cong., 1st Sess. (1973).

30. Ibid.

31. H.R. 12037, 93rd Cong., 1st Sess. (1973).

32. S. 1408, 92nd Cong., 1st Sess. (1971); H.R. 8920, 92nd Cong., 1st Sess. (1971).

33. The ABA proposal is reprinted along with S. 1408 in 117 Cong. Rec. 8518 (1971).

34. Remarks of Senator Muskie, 118 Cong. Rec. 843 (1972).

35. S. 3063, 92nd Cong., 2d Sess. (1972).

36. 118 Cong. Rec. 844 (1972).

37. See *Hearings*, supra note 14, at 27.

38. See Cohen, supra note 27.

39. H.R. 5095, 93rd Cong., 1st Sess. (1973).

40. The penalty was affixed as the lesser of 30 percent of the value of the net assets of such organization, or the amount substantiated by the organization as the aggregate tax benefit resulting from its exempt status.

41. See in Chapter 2 of this paper, "Major Arguments in Favor of Careful Restriction of Any Corrective Legislation" (fourth argument).

42. Ibid (first argument).

43. Section 501(c)(4) organizations could not engage in political campaign activities on behalf of candidates for public office.

44. The amendments of the act would have been effective for only five taxable years (taxable years beginning after December 31, 1973, and before January 1, 1979), in order to compel congressional review of the act's effect.

45. H.R. 12037, supra note 31.

LIMITATIONS ON LOBBYING BY CHARITABLE ORGANIZATIONS

An Analysis Prepared for the Commission on Private Philanthropy and Public Needs[†]

I

BACKGROUND: RECENT LEGISLATIVE AND LITIGATING ACTIVITY

From 1934 to the present, the Internal Revenue Code has prohibited individuals from obtaining income tax deductions for contributions to substantial lobbying efforts carried on by charitable organizations.[1] This restriction in turn prevents those charities that seek only tax-deductible contributions from carrying on more than "insubstantial" lobbying activities with the deductible donations they have received. By contrast, an organization receiving "nondeductible" donations may carry on all the lobbying activities affordable by the nondeductible donations.[2]

Donors are more willing to contribute if they will thereby obtain tax deductions. Donee organizations, then, view as potentially more efficient those fund-raising efforts aimed at obtaining deductible donations. Accordingly, most charitable organizations choose to seek donations exclusively on a deductible basis. Having chosen not to seek nondeductible contributions, these organizations thus prevent themselves from commencing an active lobbying program.

Charities that have interests at stake in legislative controversies would naturally prefer to be able to use deductible donations to carry on lobbying programs despite the restrictions. In order to do some lobbying, a number of charitable groups have organized themselves into two tax entities – a "deductible" organization which does not lobby, and a "nondeductible" organization, operating in tandem, which does lobby. Other charitable organizations, which may have looked with disfavor on adopting such internal organizational distinctions, have carried on lobbying programs with deductible funds and have contested the validity of the restriction on audit or in litigation.[3] The professional and scholarly literature includes articles that show a similar hostility to the restrictions, on constitutional grounds and on the ground that donations to the lobbying funds of charities ought to be deductible because business lobbying expenses are deductible.[4]

For the last seven years, charitable and bar organizations have been seeking legislation to modify the restrictions so as to enable donors to obtain deductions for gifts to charities' lobbying programs. In 1969 the American Bar Association formally proposed liberalization of the Code's restrictions on deductions to charity lobbying activities. In 1972 the Ways and Means Committee held hearings on a bill (H.R. 13720) to modify the restrictions. In 1973 a lengthy brief by Thomas A. Troyer, Esq.,[5] against the constitutionality of the Revenue Code's restrictions on the deductibility of donations to charities' lobbying programs appeared in the proceedings of the *New York University Institute on Federal Taxation.*[6] This article touched on most of the arguments against the deductibility restrictions and will be extensively referred to in this paper. The article discussed the major litigating activity underway at that time, the "*American United*" case, and the article itself inspired further litigating efforts to test the constitutionality of the restrictions.[7]

[†] This analysis derives from suggestions and comments made to the Commission by Associate Professor Michael J. Graetz and Assistant Professor John Calvin Jeffries, Jr., of the University of Virginia School of Law. Preliminary research, editorial advice, and occasional drafting assistance were contributed by Professors Graetz and Jeffries. The Commission staff undertook additional research and assumed responsibility for and control over the form and content of the manuscript. Accordingly, these two consultants are not specifically responsible for this paper; nor are the points of view in this discussion intended to represent viewpoints of the Commission.

In 1974 the Ways and Means Committee gave tentative approval to H.R. 12037, a much-modified version of the earlier legislation, but the bill did not pass. Supporters of deductions for charitable lobbying are currently (1976) working for enactment of the provisions of H.R. 8021, introduced in 1975 with the sponsorship of a majority of the Ways and Means Committee. Responding to the arguments that deductions should be allowed for some clearly defined amount of direct[8] lobbying activities by charities, the current bill, while retaining some of the restrictive language from existing law, does define the quantum of allowable lobbying activities.

Many charitable organizations support the principles of H.R. 8021, but some religious organizations have opposed the legislation because they believe their lobbying activities are better protected by the existing, more ambiguous statutory provisions, which in some churches' view have the advantage of not giving the IRS any specific benchmark for determining whether lobbying expenses are "substantial."

II

THE STATUTORY FRAMEWORK

The Revenue Code offers two major benefits to charity groups: it allows such groups to be exempt from income tax and it provides the groups' supporters with tax deductions for their donations.

Code section 501 provides that charities are not taxed on their investment or charity-related business income ("unrelated" business income is taxable). Code section 170 allows donors to take deductions and describes the types of charity groups that may receive such deductible donations. (The Code does not directly confer the privilege of eligibility for deductible donations on the charity groups; instead, it confers the deductibility privilege on the persons who make donations to certain kinds of organizations).

Code section 170(c)(2) describes the kinds of deductible organizations, which are among the best-known charities, such as a "trust or community chest, fund or foundation . . . for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to animals . . ." This language in section 170(c)(2) is largely mirrored in section 501(c)(3), which concerns tax exemption of charitable organizations. Most of the typical charity groups organize themselves under both of these two sections. However, these two sections offer their tax benefits only to, and only to donors to organizations "no substantial part of the activities of which is propaganda, or otherwise attempting, to influence legislation."[9] Thus, organizations that are tax exempt under section 501(c)(3), or that receive donations from donors who are taking deductions under section 170(c)(2), may not carry on lobbying with their exempt income or the previously deducted donations. In order to carry on lobbying, such groups must establish separate funds, which are tax exempt but are not eligible for deductible donations.[10]

Such separate groups are organized under a different tax exemption provision, section 501(c)(4). Some 501(c)(4) lobby groups are affiliated with 501(c)(3) groups; other 501(c)(4) groups are independent of 501(c)(3) groups. Whether affiliated or independent, the 501(c)(4) organizations are usually called "social welfare" groups because the statute refers to them this way. However, except in this tax sense, the terms "charitable" and "social welfare" generally refer to similar activities.

Most of the typical section 501(c)(3) charities are largely supported by the public and thus are treated by the Revenue Service or in the Code as "public charities." Some of these organizations, however, are supported by only a few (usually affluent) donors and are considered "private foundations." Foundations (herein the term "foundation" is used for the statutorially defined term "private foundation"), being section 501(c)(3) organizations, are forbidden to carry on "substantial . . . activities . . . to influence legislation" with deductible donations. Foundations, though, are subject to an additional restriction, that of Code section 4945, which completely bans foundation lobbying, even "insubstantial" lobbying, on general legislative issues.[11] Furthermore, the Revenue Service has never stated that foundations have the ability to lobby by means of an affiliated but separate fund.

Within the category of typical (section 501(c)(3)) charities, then, there are two subcategories: public charities and foundations. Of these, public charities may lobby by means of separate funds, but foundations, it would seem, may not.

This study uses the term "conventional charities" for conventional public charities in distinguishing these groups from social welfare groups, private foundations, and other types of charities.[12]

In summary, there are three principal kinds of organizations to be kept in mind in discussing charity lobbying:

1. *Section 501(c)(3) conventional charities,* which are eligible for deductible donations, but which may lobby, as a practical matter, only by means of an affiliated nondeductible fund;

2. *Section 501(c)(4) groups,* which may lobby, but which may only be eligible for deductible donations if the group directs the donations to an affiliated nonlobbying fund (this is the converse of case 1 above); and

3. *Private foundations,* which may not lobby on general issues in any circumstances.

Thus far, this discussion has focused on the organizations themselves. It is also useful to discuss the subject from the point of view of the donors and their eligibility to take charitable deductions.

Donors to a conventional charity may deduct their donations if the charity carries on its lobbying program in a separate fund and uses none of the deductible donations for lobbying.[13] Donors to a social welfare group may deduct their donations if the group directs those donations to a separate nonlobbying public-charity-type fund. Donors to lobbying activities carried on directly by a conventional charity, and donors to lobbying activities of a social welfare group, may not deduct their donations. Donors to a foundation can under no circumstances obtain deductions for donations to the foundation's general lobbying activities.

The Code provisions relating to the three different kinds of charity groups are written in such a way as to impose more lobbying restrictions on organizations that are more clearly controlled by a few individuals. Private foundations are by definition established by a relatively few donations from a few, usually affluent, individuals. The closer an organization comes to private foundation status, the more likely it is that the organization's choice of the charitable ends it will serve is no more than the personal choice of its donors.

This poses no problem for eligibility for deductible donations unless the organization desires to advance its ends by lobbying. When, for example, a foundation does so, Congress seems to view the lobbying as merely lobbying on donors' "personal-choice" issues.

This is less so in the case of public charities, and so such organizations are specifically permitted to have separate fund arrangements. Nevertheless, even in the case of public charities and social welfare groups, donors are by and large not allowed deductions for donations to the lobbying activity.

The disallowance of deductions for such donations suggests that the general rule concerning the statutory scheme is that Congress does not permit deductions for personal-choice lobbying, no matter how charitable are the ends served by the lobbying means. This general rule will be referred to repeatedly in the ensuing pages. The view that charity lobbying is personal-choice lobbying is supported by the widely held view that charitable donations are a form of personal consumption.[14]

The Code does not offer tax-exempt status to any businesses (except, generally, partnerships or mutual associations), but it does, at section 501(c)(5) and (6), confer tax exemption on trade, business, and professional societies, without restricting the lobbying activities of such organizations. This exemption is comparable to the exemption available for lobbying charitable groups under section 501(c)(4).

The Code also offers, to both individuals and corporations, deductions for business-related lobbying activity. Code section 162(e) allows deductions for direct (but not indirect) business lobbying. Individuals and companies may also take deductions for payments to the direct lobbying activities of their trade associations or labor unions. How comparable the treatment of these business expenses is to the treatment of expenses relating to charity lobbying is the subject of the next chapter.

III

NO PREFERENCE FOR BUSINESS LOBBYING IN PRESENT LAW

The Revenue Code denies deductions to individuals for their personal-choice lobbying, whether they do it on their own or whether they do it through a charity group. The Code grants deductions to individuals (and businesses) for business lobbying. For example, a citizen who cares about wildlife gets no deduction for lobbying against the Alaska pipeline, but the pipeline company can fully deduct its direct lobbying for the pipeline. This strikes many people as unfair. (If it is unfair, whether it is unconstitutional is still another story.) Do these provisions of the Revenue Code discriminate against charity?

Answering this question requires a recognition that expenditures for personal-choice lobbying, as opposed to business lobbying, play wholly different roles in the computation of net income. Business expenditures of any sort are always deductible, from a theoretical point of view, in the computation of net income; personal-choice expenditures are never deductible. Since our income tax is levied on net income, then business expenses should, and personal-choice expenditures should not, reduce one's tax. Lobbying expenses should be no different from any other expenses as far as this distinction is concerned.

Answering the discrimination question also requires an understanding of a "neutral" income tax system. A "neutral" net income tax system is one in which the statute exactly follows the best economic definition of net income. The concept of a neutral tax system provides a benchmark against which one can measure a statute to determine whether Congress is subsidizing or penalizing taxpayers by means of provisions in the Revenue Code. A neutral tax concept is not in all cases an ideal; a number of practical departures from it are justifiable – such as the percentage standard deduction and the dependent's exemption. Other departures from a neutral system are justified on public policy grounds – such as the deductibility of donations to charity.

A neutral system would allow full deductions for business lobbying, but would allow no deductions for lobbying on behalf of a charitable cause, which is personal-choice lobbying.[15] Persons who argue for deductions for charity lobbying are arguing for a greater subsidy for charity, not for an end to discrimination. As far as fiscal analysis is concerned, then, there is no discrimination against charity lobbying. The contrast in fiscal treatment between charity and business lobbying gives rise to no argument of discrimination and has little bearing on a constitutional analysis.

IV

CONSTITUTIONALITY: THE DOCTRINE OF UNCONSTITUTIONAL CONDITIONS

Much of the recent debate over the lobbying restrictions concerns their constitutionality. Recent articles and litigation[16] have advanced three arguments in support of the view that the lobbying restrictions are unconstitutional. First, there is the argument, based on what is called the doctrine of unconstitutional conditions, that Congress may not condition eligibility for receipt of deductible contributions by a conventional charity on forbearance from engaging in a protected First Amendment activity such as lobbying. Second, some persons suggest that the equal protection guarantees in the Constitution forbid Congress to grant unequal tax subsidies for legislative activities by different kinds of charities, or unequal subsidies to donors to different kinds of charities. Third, there is the view that the present statutory scheme is impermissibly vague. This chapter analyzes the doctrine of unconstitutional conditions. The other two constitutional arguments are dealt with in the two succeeding chapters.

Preliminarily, it will be useful to review the doctrine of unconstitutional conditions and to summarize the arguments made by critics of the existing law. A relatively recent proposed statement of the unconstitutional conditions doctrine is Professor Van Alstyne's article entitled "The Demise of the Right-Privilege Distinction in Constitutional Law."[17] The N.Y.U. article mentioned in Chapter I relies extensively on the Van Alstyne analysis, as does this chapter.

Van Alstyne quotes an early statement of the idea of unconstitutional conditions by Mr. Justice Sutherland in *Frost v. Railroad Commission:*[18]

> *It would be a palpable incongruity to strike down an act of state legislation which, by words of express divestment, seeks to strip the citizen of rights guaranteed by the federal constitution but to uphold an act by which the same result is accomplished under the guise of a surrender of a right in exchange for a valuable privilege which the states threaten otherwise to withhold . . . If the state may compel the surrender of one constitutional right as a condition of its favor, it may, in like manner, compel a surrender of all. It is inconceivable that guarantees embedded in the Constitution of the United States may thus be manipulated out of existence.*

Van Alstyne restates the doctrine thus:

> *[W]hatever an express constitutional provision forbids government to do directly it equally forbids government to do indirectly. As a consequence, it seems to follow that the first amendment forbids the government to condition its largess upon the willingess of the petitioner to surrender a right which he would otherwise be entitled to exercise as a private citizen . . .*
>
> *. . . The doctrine would appear to apply equally well to every other case where the enjoyment of a government-connected interest is conditioned on a rule requiring that one abstain from the exercise of some right protected by an express clause in the Constitution.*[19]

Van Alstyne admits to only one "major" limitation on the doctrine: the petitioner must demonstrate that the condition of which he or she complains is unreasonable in the special sense that it prohibits or abridges the exercise of a right protected by the Constitution. In applying the doctrine, according to this view,[20] a court need simply apply a given constitutional provision in order to forbid government from conditioning its largesse on any waiver of such a provision regardless of the circumstance: " . . . a court may seem to have but a single straightforward question to resolve; did the regulation in question condition the petitioner's privilege upon the waiver of a named constitutional right?[21] Usually, courts have applied the doctrine only to statutes or regulations that directly forbid the enjoyment of an explicit constitutional right, rather than where the conditions of the government benefit have only an indirect effect on such a right and do not directly and wholly forbid its exercise. However, where a statute indirectly burdens a right, the courts may balance the governmental concern against the extent of the burden to determine whether the statute is constitutional.[22]

Critics of existing law have suggested that the doctine of unconstitutional conditions is clearly applicable to the statutory restrictions on receipt of tax deductible contributions by conventional charities. Simply stated, the argument runs as follows. Lobbying is constitutionally protected by the First Amendment right to petition the government and by the broader guarantee of freedom of speech. The lobbying restrictions for conventional charities condition a valuable governmental benefit – entitlement to receive and use contributions deductible to the donors – on forbearance from exercise of a constitutionally protected right. "Deductible" charities must indeed forbear from active lobbying; more precisely, if they choose to carry on lobbying programs, they must do so by means of affiliated funds rather than directly. Therefore, the unconstitutional conditions argument concludes, the statutes governing receipt of deductible contributions by charities are indirectly equivalent to a direct and explicit legislative proscription of lobbying. Presumably, a direct ban on lobbying would violate the First Amendment. Therefore, the tax statutes are also unconstitutional because "Whatever an express constitutional provision forbids government to do directly it equally forbids the government to do indirectly."

This argument is appealing. Analysis, however, suggests that it is seriously flawed. The doctrine of unconstitutional conditions, while essentially sound, is susceptible to overstatement. It seems clear that the government should not be allowed to eviscerate constitutional guarantees by indirection and subterfuge. This is not say, however, that every act of government regulation indirectly or tangentially affecting the manner of exercising constitutional rights is equivalent to direct legislative negation of protected freedoms. Many government actions limit or affect some aspect of self-expression or political discourse. Even in the more problematical context of governmental largesse explicitly conditioned on forbearance from protected activity, there is much that government may do. For example, a political appointee may be told that continued employment is conditioned on forbearance from public criticism of official policy. However undesirable this may seem, it is not equivalent to a flat governmental prohibition on public comment. Similarly, a public school may tell its teachers that their jobs are at risk if they make racist comments in the classroom. Such a policy is, in constitutional terms, not tantamount to a law prohibiting such comments generally.

Recent authority from the Supreme Court confirms the view that the doctrine of unconstitutional conditions means rather less than is sometimes supposed. In *Civil Service Commission* v. *National Association of Letter Carriers*[23] the Court confronted a claim of unconstitutional conditions more persuasive than that of a charity required to establish a separate fund in order to lobby. In *Letter Carriers*, the principal plaintiff, a labor union of federal employees, sued to invalidate 5 U.S.C. section 7324(a)(2), which forbids certain partisan political activities by such employees. The Court concluded that the elimination of political favoritism from the programs of government was a valuable purpose and "unhesitatingly" reaffirmed that Congress has the power to prevent civil servants from engaging in partisan political activity. Thus, the Court in *Letter Carriers* upheld its similar 1947 decision in *United Public Workers* v. *Mitchell*.[24] Significantly, that earlier case was identified by Van Alystyne as incorrectly decided under a literal application of his rules.[25] At the very least, *Letter Carriers* signals a brake on the overstatement implicit in an abstract formulation of the doctrine of unconstitutional conditions. The crucial considerations are the context of the government action and the content of its impact on protected freedoms. It is worth noting that *United Public Workers* and *Letter Carriers* involved statutes flatly prohibiting partisan political activities by persons holding civil service positions. As the next section of this chapter will show, nothing comparable is involved here.

Except by means of an expansive statement of the doctrine of unconstitutional conditions, the doctrine is largely inapplicable to the charity lobbying issue. To demonstrate why this is so, one must consider how the lobbying restrictions apply to charities receiving deductible contributions, the consequences of those restrictions, and the strength of the federal policy behind the restrictions.

The N.Y.U. article follows the Van Alstyne analysis at its broadest formulation. Accordingly, the impact of the lobbying restrictions is phrased this way: "The effect of the restrictions . . . is to withhold or withdraw the privileges of tax exemption and qualification to receive deductible contributions from charities which engage in specified First Amendment activities of more than an insubstantial amount."[26] In fact, the Code does not forbid tax exemptions for charitable organizations that engage in more than in insubstantial amount of lobbying. Section 501(c)(4) allows such organizations to retain tax-exempt status.

Of course, many eleemosynary groups want more than tax exemption of their income. They also wish to be eligible to receive deductible contributions under section 170(c). For this reason, most conventional charities seek tax exemption not under section 501(c)(4), which permits lobbying, but rather under 501(c)(3), which parallels the provision authorizing deductibility of contributions by donors and which does restrict lobbying. Thus, it is not really tax exemption of the charity which is at stake but rather deductibility of contributions by donors.

Once attention is squarely focused on the deductibility of contributions by donors, the unconstitutional conditions argument seems less strong. Donors do obtain tax benefits if they channel their donations to charities that do not engage in lobbying. Such channeling is a condition for receiving the government benefit of a tax deduction for contributions. But where is the unconstitutional condition? Donors are not required to give up their protected right to lobby in return for obtaining deductions. On the contrary, the right of donors to lobby is unimpaired. They may spend their funds to lobby on any personal-choice issue just as they may use their resources to purchase any other item of consumption. But they must lobby with after-tax dollars. This is true whether the donors lobby individually or through tax-exempt charitable organizations or in any other way not related to the net income concept underlying the tax laws. Thus, the availability of deductions for contributions to charities is not conditioned in any way on forbearance by donors of exercise of their constitutional rights.

It is true, of course, that lobbying activities are not treated as favorably as they might be. The government could establish the policy that it would subsidize lobbying as a particularly favored form of personal consumption. For purposes of constitutional analysis, however, this point is irrelevant. The fact that the government could favor lobbying by authorizing deductions for lobbying expenditures does not mean that it has to do so. Simply to ask the question whether donors have a First Amendment right to insist on deductibility of lobbying expenditures provides its own answer. Neither the N.Y.U. article nor any other commentator of note has suggested that the denial of deductions for lobbying expenditures not incidental to the production of income contravenes any constitutional principle. Yet in a real sense that is all that is involved in the lobbying restriction imposed on charities receiving deductible contributions.

The argument is made that although lobbying restrictions do not infringe the rights of donors, they do infringe on the First Amendment rights of the charities themselves. The position advanced is that the proper focus of analysis is the charity as an independent entity, which is denied the valuable benefit of receiving tax deductible contributions unless it forbears from more than an insubstantial amount of lobbying. This argument is rebuttable on two grounds. First, it places form over substance. The practical consequence of removing the lobbying restrictions on section 501(c)(3) organizations, would be to allow donors to deduct expenses for personal-choice lobbying so long as the funds are pooled together with donations from other like-minded individuals. Congress instead chose to ignore the formality of an independent legal entity, particularly in the case of foundations, and concentrate on the reality of the situtation. Otherwise, the decision not to subsidize personal-choice lobbying would be effectively undercut by the use of a charitable organization to make lobbying expenditures. Second, the restriction on lobbying applicable to section 501(c)(3) organizations, which receive deductible funds, does not apply to such organizations which take the trouble to reorganize themselves so as to be affiliated with section 501(c)(4) organizations to pursue the same charitable ends by means of lobbying with nondeductible contributions. Specifically, under Revenue Ruling 54-243,[27] a section 501(c)(3) organization would seem to be free to reconstitute itself as a section 501(c)(3) group affiliated with a separately organized 501(c)(4) entity. The Service will insist that none of the operations and resources of the section 501(c)(3) fund be employed to support lobbying activities of the section 501(c)(4) fund and may even take an expansive view of what activities are related to lobbying. If, however, a lobbying group obtains nondeductible contributions on its own, the section 501(c)(3) part of the entity will definitely continue to be eligible for deductible contributions. This is surely the case where the work of the section 501(c)(3) effort is not merely for exploitation by the affiliated lobbying fund.

The N.Y.U. analysis analogizes setting up an affiliated lobbying fund to creating another person to exercise protected liberties. This analogy is intended to set up the argument that conditioning a government benefit on forbearance from exercising constitutional rights by one person is not cured by the fact that another person may exercise those rights. A separate section 501(c)(4) organization, however, is not another person but is rather only an affiliated entity controlled by the same persons who run the section 501(c)(3) charity and serving the same charitable purposes. As a practical matter, creating a separate 501(c)(4) organization for lobbying only has the consequence of requiring that lobbying be conducted with nondeductible contributions. The administrative burden of creating a separate fund is small. Thus, the tax statutes create a scheme with a minimum burden required to effect the policy judgment against tax subsidies for personal-choice lobbying. The only burden imposed on a charity is that it cannot elicit deductible contributions and engage in substantial lobbying with those contributions. But it can create a separate but affiliated fund to lobby with nondeductible contributions. In either event, the income of the charity itself is tax exempt.

Also requiring analysis is the federal interest in disallowing deductibility of donors' personal-choice lobbying. The government policy behind the lobbying restrictions is typically described as the judgment that the public fisc should not subsidize lobbying, which is simply one form of consumption by the donors. The classic statement of this rationale comes from Judge Learned Hand's opinion in *Slee* v. *Commissioner:*[28] "Political agitation as such is outside the statute, however innocent the aim . . . Controversies of that sort must be conducted without public subvention; the Treasury stands aside from them." *Slee* bars deductions by individuals for donations to charities heavily engaged in noneducational lobbying. The definition of eductional seems to connote an effort to provide a legislative body with all the facts on a particular issue as distinct from an effort to proselytize for one side of any of "the many causes in which ardent persons engage."[29]

Quoting *Slee*, the Supreme Court, in *Cammarano* v. *United States*, [30] added that "Nondiscriminatory denial of deduction . . . is . . . a determination by Congress that since purchased publicity can influence the fate of legislation which will affect, directly or indirectly, all in the community, everyone in the community should stand on the same footing as regards its purchase so far as the Treasury of the United States is concerned." According to *Commissioner*, this is a "sharply defined national policy."[31] *Commissioner* involved restrictions on deductibility of business lobbying (in that case, indirect lobbying); *Slee* was a charitable donor case.

Judge Hand's reference in *Slee* to "ardent persons" rather than to organizations and the fact that *Slee* was a donor's case are important. Contributions to charities are personal expenditures by the donors. Allowing deductibility of such contributions amounts to a tax subsidy for specified forms of consumption. Disallowing deductibility for lobbying expenses, whether incurred directly by individuals or through a charity entitled to receive deductible contributions, represents a federal policy against public subvention of personal-choice lobbying. Charity lobbying is personal-choice lobbying even though the issues involved may be matters of public concern. The donor chooses the issue or interest which he seeks to advance through lobbying. Thus, for example, a contributor to a conservation organization chooses to spend his or her resources on behalf of conservation efforts. A goal of the federal policy of denying public subsidies to the latter form of consumption is to avoid public subsidy to lobbying on behalf of the political preferences of persons most able to make donations to their personal causes. The policy is directed at donors rather than at the charities themselves, as consideration of the provision for tax-exempt lobbying organizations under section 501(c)(4) makes clear.

The policy against public subsidy of lobbying on personal-choice issues has been part of the Internal Revenue Code for 42 years. For 16 years prior to that, business deductions for lobbying were prohibited under Treasury regulations.[32] Most recently, as part of the Tax Reform Act of 1969, Congress enacted section 4945 of the Code, which deals with lobbying activities by private foundations. Recognizing that foundation lobbying may represent nothing more than the personal political preferences of founders, major donors, and managers, Congress enacted section 4945 to forbid foundation lobbying. Thus, it is now impossible for a donor to obtain a deduction for a contribution to the lobbying efforts of a foundation or for a foundation to receive deductible contributions to its lobbying activities. The rationale, of course, is the same as that reflected in the lobbying restrictions on conventional public charities: the public should not subsidize political preferences of individuals, whether through direct personal lobbying or through use of some intermediate entity to accomplish the same result.

V

CONSTITUTIONALITY: EQUAL PROTECTION

A frequent criticism of the deductibility restrictions on lobbying is that they abridge the right to equal protection of the laws.[33] The right to equal protection is, generally, the right not to be discriminated against where there is no proper basis for discrimination. Exactly what is a "proper basis" is a federal constitutional question.

Critics of the restrictions argue that conventional charities (which, of course, are exempt organizations) are discriminated against as compared with tax-exempt business trade associations, tax-exempt labor unions, and businesses generally. Another argument is that conventional charities are discriminated against as compared with fraternal and veterans organizations. A third argument is that donors to conventional charities are discriminated against as compared with persons making payments to or donations to other organizations.[34]

The Fourteenth Amendment guarantees to all citizens the right of equal protection under state laws. No provision of the Constitution similarly states that citizens have this right under federal laws, but the guarantee of due process in the Fifth Amendment, which protects the rights of citizens relative to federal laws, is generally agreed to "incorporate" a guarantee of equal protection. The Supreme Court has never flatly stated that the due process clause of the Fifth Amendment incorporate the equal protection guarantees of the Fourteenth Amendment, but it has gone so far as to say, in the recent case of *Johnson* v. *Robison*, that "if a classification would be invalid under the Equal Protection Clause of the Fourteenth Amendment, it is also inconsistent with the due process requirement of the Fifth Amendment."[35] The usual way of framing an equal protection argument is to contend that a benefit is being granted to some persons and not to others on a basis which is arbitrary, capricious, or otherwise not supported by a valid difference between the two classes of persons, hence constituting an impermissible discrimination.

Due process standards do apply to the federal taxing power.[36] However, the Supreme Court has ruled that due process standards will require the invalidation of tax statutes only in "rare and special circumstances." To be invalid, a statute must be sufficiently excessively "arbitrary and capricious" that it is "so wanting in basis for classification as to produce . . . a [confiscatory] gross and patent inequality."[37]

In due process challenges to federal income tax statutes, the classification must, then, be arbitrary in the extreme in order to violate the Fifth Amendment. In fact, the Supreme Court has never struck down the substance of a federal income tax statute on due process grounds.[38]

A recent statement of the due process standards applicable to the federal tax power is in *United States* v. *Maryland Savings-Share Ins. Corporation*.[39] This case arose when Maryland Savings-Share, a state-established institution which insured deposits in state-chartered savings and loan associations, sought an exemption from federal income tax. All such institutions were granted tax exemptions until 1960, when Congress, by statute, limited exemptions to institutions organized before September 1957. The Maryland insuror was organized in 1962. The Court sustained the cutoff date, holding that a legislative classification will normally be upheld "if any state of fact rationally justifying it is demonstrated to or perceived by the courts."[40] (There were some such facts available in the legislative record.)

The Code's restrictions on charity lobbying are constitutional under this test if there are any factual distinctions between conventional charities and the various other kinds of tax-exempt charities and organizations to which charities are contrasted (with respect to lobbying), or any distinctions between persons making donations to conventional charities and persons making payments or donations to the other organizations, which would justify different treatment in relation to lobbying.

In *Cammarano* v. *United States* [41] the taxpayer, a Washington State beer distributor, made contributions to help finance a statewide publicity program to defeat an initiative to place retail wine and beer sales under state control. The taxpayer argued that the Treasury regulations which denied deductions for such contributions placed such a burden on a form of speech that the regulations violated the First Amendment. The Court held that this argument was meritless, stating that the taxpayer was "simply being required to pay for those activities out of [its] own pockets, as everyone else engaging in similar activities is required to do" on a "[n]ondiscriminatory" basis. The Court stated that everyone in the community should stand on the same footing as regards purchased lobbying so far as the Treasury of the United States was concerned, and called this a "sharply defined national policy."[42]

Cammarano was decided three years prior to the Revenue Act of 1962, which added subsection 162(e) to the Code, allowing deductions for direct business lobbying. In light of the 1962 Revenue Act, a lobbying charitable organization could now direct the Supreme Court's attention to the denial to its donors of deductions, and the simultaneous allowance of deductions for business lobbying. Is this situation sufficiently discriminatory to require, under the *Maryland Savings-Share* test, invalidation of the deductibility restrictions?

The answer is surely no. Even the most hostile critic of the lobbying restrictions would concede that there are factual distinctions between conventional charities, and trade associations, labor unions, and ordinary businesses which provide at least some support for different treatment in relation to lobbying. Not only are there such factual distinctions, but there are also fundamental analytical differences between these organizations, as elaborated upon in Chapter III. Differences among these groups serve equally to differentiate persons making payments (for example, donors) to such groups. There is no doubt that these differences enable Code section 170(c)(2) and its counterparts to withstand, under the *Maryland Savings-Share* test, an equal protection attack in this context.

From the viewpoint of fiscal analysis, there are fewer differences between conventional charitable organizations and veterans and fraternal organizations. However, the factual differences among them also are sufficient to enable congressional distinctions along the same lines to withstand an equal protection attack.[43] The congressional distinction among various kinds of charitable groups is not a classification system that burdens constitutional rights in any material way. All donors may direct their donations to lobbying activities; some donors, to ordinary charitable causes, will receive no tax deductions for doing so; others, donors to fraternal and veterans organizations, will receive tax deductions; but no one's right to expression is burdened. All charitable causes may carry on lobbying activities; conventional charitable organizations must conform to certain administrative requirements — establishing an affiliated fund — in order to do so. Any such administrative requirements are not burdens sufficient to require the kind of strict judicial scrutiny applied, for example, in the 1968 equal protection case of *Shapiro* v. *Thompson*,[44] to determine that they are supported by a sufficently strong federal interest. However, the federal interest in denying deductions for personal-choice lobbying should be sufficient to withstand such scrutiny, being, according to *Cammarano*, a "sharply defined national policy."

Classifications based on criteria over which an individual has no control, such as race or national origin, also trigger special judicial scrutiny under the equal protection clause. Such classifications are considered "suspect" or "invidious."[45] A court will very carefully examine a statute embodying an acknowledgedly suspect classification before it will uphold it.

The only possible suspect class issue concerning charity lobbying relates to a distinction between large and small charities. It has been argued that large charities, even though a "substantial" part of their activities may not consist of deductible lobbying, can nevertheless carry on effective lobbying programs because even an "insubstantial" part of the activities of a large charity may be considerable on an absolute scale. By contrast, it is argued, since *any* part of a small charity's activities may be "substantial" in relation its total activities such a charity may never permissibly carry on an effective lobbying program. This classification may be suspect or invidious because the ability to exercise First Amendment protected rights seems to turn on the relative "wealth" of the organizations, a distinction which seems, on first examination, to be distasteful. In the U.S. Court of Appeals (D.C. Circuit) proceedings in *"Americans United" Inc.* v. *Walters* the charity plaintiff argued that the "size" of a conventional charitable organization is "directly related to its wealth and power structure . . . allowing larger, richer organizations more 'dollar punch'. . . ."[46] The court of appeals concluded that this argument raised a "substantial constitutional question" under 28 U.S.C. section 2201.

The Supreme Court has since defined suspect wealth classifications in such a way as to eliminate the possibility that this argument has any validity, in *San Antonio Independent School District* v. *Rodriguez*,[47] which was handed down about two months after the Court of Appeals considered *"Americans United."*

Rodriguez involved an action by certain Texas school students from poorer school districts. They argued that the state system of financing public schools (by means of realty taxes on tax bases which varied markedly among school districts) had the effect of providing low-quality education to poor families, resident in poor districts, and high-quality education to affluent families, resident in affluent districts. If this premise were accepted, then the Texas system discriminated, on the basis of wealth, in the provision of education. If the right to a public education were a fundamental constitutional right, and if wealth was a suspect classification, then the school finance system violated the Fourteenth Amendment. The Court held that discrimination based on wealth would only be suspect where a statutory framework had the effect of completely barring eligibility for a valuable benefit because of individuals' inability to pay.[48]

The Revenue Code's restrictions on charities' lobbying with deductible funds do not have the effect of depriving indigents of benefits, which would seem to be the limits of the wealth classification doctrine as defined in *Rodriguez*. No Supreme Court opinion reviewed in this research has intimated that wealth might ever be a suspect classification for legal entities other than natural persons. Accordingly, the wealth classification argument in *"Americans United"* would fail as an attack on the deductibility restrictions in the Code.

VI

CONSTITUTIONALITY: VAGUENESS

A third major argument for the proposition that the deductibility restrictions violate the Constitution is that the language of the restrictions is impermissibly vague. Critics of the restrictions single out the term "substantial part" as being particularly ambiguous. Litigative challenges have also focused on the term "propaganda" and the phrase "attempting to influence legislation."

Vagueness arguments are based on the principle that the due process guarantee of the Constitution requires that the ordinary citizen have notice of a law before he or she may be subject to its exactions.[49] A leading article on unconstitutional vagueness,[50] by Professor Anthony Amsterdam, suggests that those statutes most likely to be judicially struck down as vague are those that appeal to judgment or that involve a question of degree. Critics of the deductibility restrictions suggest that the term "substantial" is such a term and therefore it may be defectively vague.

The New York University article[51] examines the language of Code sections 170(c)(2) and 401(c)(3) in the context of the regulation of constitutionally protected activities, in this case, primarily, speech. Statutes which regulate protected activities are held to higher standards of specificity. A vague statute requires the citizen to restrict his or her conduct to a greater extent than Congress may have intended or than Congress could explicitly command. A vague statute lends itself to subjective enforcement. In the case of the deductibility limitations, deductible activities may be reclassified as nondeductible activities simply by virtue of being carried on simultaneously with an "attempt to influence legislation." The critics of the deductibility restrictions argue that the statute has all these faults. They also argue that if the use of "substantial part" refers to some fixed proportion or percentage, it is impossible to discern this percentage, or of what it is a percentage, from the statutory language.

As an initial matter, the critics have a difficult task in establishing that a federal statute is unconstitutionally vague. To 1960, in fact, the Supreme Court had nullified only two federal statutes on vagueness grounds. Most statutory terminology, of course, is more or less readily definable. Terms definable by reference to objects of common experience are less likely to be found unacceptably vague. Terms found in the common law, in administered statues, in civil rather than criminal statutes, or in older statutory provisions have historically been less likely to be found deficient.[52] Terms in statutes having the effect of regulating speech, however, have indeed been held to a higher standard of precision.

The case seems strong that the two concepts of "propaganda" and "attempting to influence legislation" are in the category of "abstractions of common certainty" found in the Amsterdam article not to have been struck down by the Supreme Court. *Webster's Third New International Dictionary* defines "propaganda," generally, as one-sided advocacy. The Supreme Court has defined "to influence . . . legislation" in *United States* v. *Harriss* and in *United States* v. *Rumely*, both cases from the 1950's.[53] Both terms are defined in detail in the Income Tax Regulations at section 1.501(c)(3)-1(c) and -1(d).

The critics would argue that the term "substantial part," however, is not an "abstraction of common certainty." Instead, they argue, "substantial part" is a member of a class of terms which, according to Amsterdam, is more likely to be struck down by the Supreme Court on vagueness grounds – terms which involve an appeal to judgment or a question of degree. *Webster's* offers as various synonyms for "substantial" such terms as material, real, important, essential; considerable; and carrying weight, as in "substantial evidence." *Black's Law Dictionary* (4th ed. 1968) offers as synonyms such terms as real, considerable, actual, something of worth, and material.

Interpretations of "substantial part" appearing in past decisions construing the deductibility restrictions are, for example, "essential," "not incidental;"[54] significant;[55] not "minor;"[56] and not "small," more than "sporadic," and of "consequence."[57] In none of these cases, however, did a court rule on any constitutional challenge to the term of vagueness grounds.

The major role played by the "substantial" test is to place a procedural requirement on the principals (the officers, who may also be the donors) of a conventional charity.[58] Such persons may not use the deductible donations the group is receiving – that is, gifts from persons who are taking charitable deductions for the gifts – for a regular lobbying program. When these officers of a charity wish to commence "substantial" lobbying activities, they must establish an affiliated section 501(c)(4) fund to accept nondeductible contributions, which may be spent on lobbying. Nothing tells such persons how much lobbying they may do without setting up an affiliated fund. On the other hand, nothing in the Code prevents them from setting up such a fund. Nothing in the Code prevents them or the charitable enterprise from lobbying. There is no restriction on the speech of the donors, of the charity group officers, or of the charitable enterprise. It is simply that in the case of donors to or principals of a conventional charity, they must comply with an administrative requirement before the charity may start a regular lobbying program.

There is no authority involving precisely this situation. The most clearly analogous situation involves lobby registration. Under 2 U.S.C. section 267, no one may become a full time lobbyist without registering with the Congress. Registration calls for disclosure of the lobbyist's associates' names, employment situation, specific activities, and expenditures, and is required every three months. These requirements, considerably more onerous than a requirement to channel nondeductible lobbying donations through a separate lobbying fund, were upheld in *United States* v *Harriss*.

Harriss is strong authority that the "substantial" test of Code section 170(c)(2) is not defectively vague. This is especially so because in *Harriss* the statute was under attack as an abridgement of First Amendment freedoms of speech and of the right to petition the government because the statutory terms "to be used principally to aid" and "the principal purpose" appearing in 2 U.S.C. section 266 were alleged to be fatally vague.

The Court cited the legislative history of the act to indicate that the term "principal" was adopted merely to exclude from the scope of section 266 those persons and contributions having only an incidental purpose of influencing legislation. The decision went on to distinguish between incidental and primary purpose as follows:

> [T]he 'principal purpose' requirement does not exclude from the coverage of the Act a contribution which in substantial part is to be used to influence legislation through direct communication with Congress or a person whose activities in substantial part are directed to influencing legislation through direct communication with Congress . . .[59]

The case of *Civil Service Commission* v. *Nat'l Ass'n of Letter Carriers*[60] involved, in part, a vagueness challenge to a provision[61] of the Hatch Act, which limits efforts by federal employees to influence, politically, other persons and to influence the electoral process. The Hatch Act comprises an extensive and detailed legislative framework designed to regulate participation in activity which is clearly protected under the Bill of Rights. Thus the act imposes drastically stronger restrictions on First Amendment-protected activity than does Code section 170(c)(2). In such a situation, vague terms were much more likely to be struck down than in the case of the Revenue Code restrictions.

Prior to Supreme Court consideration of the case, a three-judge district court had invalidated the act on vagueness grounds,[62] in the process referring to principal precedents setting forth the vagueness doctrine.[63] The Supreme Court, however, reversed the district court and upheld the statute. The challenged portion of the act imposes penalties on political activity which is "active" (as opposed, presumably, to "inactive");[64] the act also restricts activity which is "specifically" (as opposed to "generally") identified with a political party.[65] Pursuant to regulations, the act places restrictions on activity the "real" purpose of which is indirectly to evade the act;[66] on being identified "prominently" with political movements;[67] and on certain activity which "materially" compromises the federal service.[68]

The fact that in *Letter Carriers* the Supreme Court upheld the use of the term "active," even when it was defined by terms such as "real" and "material," which are synonymous with "substantial," strongly indicates that a challenge to the phrase "substantial part" in the deductibility restrictions would not be successful.[69]

Words and Phrases (West, permanent edition) lists only two federal cases in which the opinions discuss challenges to the term "substantial" as being so vague as to be constitutionally defective. In both these cases, the courts held that the term was sufficiently specific.

In *United States* v. *Whyel et al.*,[70] the taxpayer alleged that section 240(b) of the Revenue Act of 1918 was unconstitutional because the statute fixed no definite percentage of stock, but instead used the expression "substantially all the stock" in setting the degree of common ownership deemed to render corporations affiliated; affiliated corporations were potentially liable for higher excess profits taxes. The opinion of the district court does not unambiguously describe the challenge to the term as a vagueness challenge on constitutional grounds. The court held the statutory phrase to be synonymous with "effective[ly]" all and "actually" all, and did not dwell on any constitutional considerations.

In *Newman v. Piggie Park Enterprises*[71] the district court sustained the constitutionality of the term "substantial portion" which appeared in the public accomodations provisions of the 1964 Civil Rights Act.[72]

Plaintiffs brought suit against the corporate defendant alleging that the defendant violated the Civil Rights Act by denying service to the plaintiffs at several fast food barbeque restaurants solely upon the grounds that they were Negroes. As one of its defenses, the defendant contended that the phrase "substantial portion of the food which it serves. . .has moved in commerce" was so vague and indefinite as to make it impossible to determine whether a person came within the act.[73]

The court, in determining that the term "substantial" was not vague, used the definition contained in *Black's Law Dictionary* (supra), which the court said was the term's "usual and customary" meaning.[74] The court apparently felt that regulatory language capable of routine definition necessarily survived the constitutional vagueness arguments apparently raised by the defendant, for the court did not go beyond the dictionary in defining the term and holding the term to be sufficiently definite.

Examination of entries in *Words and Phrases* for the synonyms nominal, actual, valuable, worthwhile, finite, and material do not reveal a federal case where any of these terms have been held vague.[75]

As in the cases construing the term "substantial," the courts have interpreted the meanings of similar modifiers according to the factual considerations of the cases before them and in line with their plain meaning.[76]

In addition to construing the term "substantial" as it is used in the context of the charitable contributions provisions, the federal courts have interpreted the term in other statutes by reference to, for example, legislative history,[77] administrative interpretation,[78] ratio or relative value,[79] and a factual or case law determination.[80] The term "substantial" and its cognates appear in the Revenue Code 271 times (1972)[81] and have never been held unduly ambiguous.

Given the authority of *Harriss* and *Letter Carriers*, reference to the cases subsequently discussed is almost unnecessary. In *Harriss*, administrative restrictions on lobbying, even when the restrictions contained imprecise terms, were upheld. In *Letter Carriers*, actual prohibitions on First Amendment-protected activity were upheld in the face of the contention that the prohibitions were vague. Both cases involved terms similar to the terms of the deductibility restrictions.

VII

CONSTITUTIONAL QUESTIONS RAISED BY ALLOWING DEDUCTIONS FOR PERSONAL-CHOICE LOBBYING

If Congress were to provide tax subsidies for personal-choice lobbying by individuals, it would create constitutional problems in at least two areas. One problem raised by repealing the restrictions concerns the relationship between individual wealth and the exercise of First Amendment-protected rights and freedoms. A second problem concerns the role of religious organizations in political debate. These problems would seem not to be of a magnitude sufficient to invalidate a statute granting charitable deductions for lobbying, but do raise questions as to whether such a statute would embody sound constitutional policy.

The first such problem involves the varying impacts on different economic levels of donors of a tax subsidy for donations to charity lobbying. The issue arises because of the way the charitable deduction system works. This deduction is primarily of benefit to those individual taxpayers whose itemized deductions are greater than their standard deductions.[82] As a practical matter, this means that the charitable deduction is not of benefit to any indigent or poor families no matter how much they give to charity, because such families receive no tax subsidies,[83] and it is not of obvious benefit to the roughly one half of individuals (and families) who do not itemize their deductions. For taxpayers who do itemize their deductions, the deduction reduces their taxes by an amount ranging from 14 percent to 70 percent[84] of the total of the contributions. The wealthier the contributors, generally, the larger the tax subsidies, in dollar terms, for the contributions.[85]

Tax deductions for lobbying on personal-choice issues would subsidize the First Amendment-protected activities of some taxpayers. However, a system of such deductions would completely deny subsidies to poor individuals and families, and deny subsidies to many middle-income taxpayers who do not itemize their deductions. Briefly put, such a system subsidizes First Amendment-protected activities of individuals in direct relation to their wealth. Subsidizing the political activities of the wealthy may impinge on the protected freedoms of the poor by making their rights less valuable.[86]

As an initial matter, this system seems repugnant to American principles of fair play.

In the analysis of such a subsidy program, the Supreme Court's opinion in *Rodriguez* (supra) seems a useful starting point. As the Court there stated,[87] the individuals who were discriminated against in pre-*Rodriguez* cases in which the Court struck down statutory or regulatory schemes relating to wealth "shared two distinguishing characteristics: because of their impecunity they were completely unable to pay for some desired benefit, and as a consequence, they sustained an absolute deprivation of a meaningful opportunity to enjoy that benefit." Typically, in the cases cited or discussed in *Rodriguez*, a showing of indigency sufficed to demonstrate that an individual simply could not pay for something—a transcript,[88] counsel,[89] a fine,[90] or an election filing fee[91]—and as a result the individual was disadvantaged in a setting in which constitutional protections play a foremost role, such as a criminal trial and appeal[92] or a campaign for public office.[93]

In the case of a deductible contribution to a charitable lobbying cause, the federal government, generally, would benefit the donor by refunding a portion (14 percent to 70 percent) of the donation. However, an indigent donor, for no reason other than indigency, would be ineligible for a benefit.

Deductible status for charities' lobbying would be a result of a decision by Congress to facilitate the exercise of a right or freedom with cash subsidies, but to deny eligibility for the subsidies to all poor individuals and families. The indigent individual would not be eligible for a subsidy and as a consequence would be disadvantaged in a setting—the exercise of First Amendment-protected rights—in which constitutional protections play a major role. Thus tax expenditures for lobbying on personal-choice issues, because of the peculiar operation of the tax subsidy system, might embody a constitutionally questionable classification.[94]

A second constitutional problem which would arise if all organizations were allowed to lobby with deductible donations lies in the resulting increased involvement of churches in legislative controversies.

It is a well-known maxim that the government shall not, under the Establishment Clause of the First Amendment, become "entangled" in religious affairs. An equally important First Amendment-inspired principle, however, is that religious organizations should not become excessively entangled in politics. This second rule is articulated in a number of opinions of the Supreme Court.

The 1971 decision in *Lemon* v. *Kurtzman*[95] includes a succinct statement of this principle: "Under our system the choice has been made that government is to be entirely excluded from the area of religious instruction and churches excluded from the affairs of government." In this case, the Court struck down, on establishment grounds, Pennsylvania and Rhode Island programs which paid a portion of salaries of teachers in parochial schools. The Court held that it was forbidden for a state to pay salary money to these teachers and that the programs created excessive "entanglement" between the states and the churces, in the form of enforcement. An additional type of entanglement invalidating the programs was the potential for involvement of religion in lobbying and campaign activities relating to state aid:

> Ordinarily political debate and division, however vigorous or even partisan, are normal and healthy manifestations of our democratic system of government, but political division along religious lines. . .is a threat to the normal political process. . . It conflicts with our whole history and tradition to permit questions of the Religion Clauses to assume such importance in our legislatures and in our elections. . . The history of many countries attests to the hazards of religion's intruding into the political arena. . .[96]

In *Committee for Public Education* v. *Nyquist*[97] the Court struck down, as violating the Establishment Clause's prohibition against financial support for religion, a wide-ranging New York State aid program for private and parochial education. In light of this holding the Court did not feel it necessary to decide whether the aid program would also result in excessive entanglement of the state with religion, in the sense of comprehensive and specific state enforcement. However, as the Court observed, aid to church schools carries grave potential for entanglement in the broader sense of continuing political strife over aid to religion, characterized by aggressive and divisive lobbying to get, maintain, or increase appropriations and tax relief.[98]

Justice Black, dissenting in *Board of Education* v. *Allen*,[99] a decision which approved a statute authorizing a state to supply textbooks to students in parochial schools, focused more specifically on lobbying: "The same powerful sectarian religious propagandists who have succeeded in securing passage of the present law. . .doubtless will continue their propaganda, looking toward complete domination and supremacy of their particular brand of religion." And Justice Jackson, dissenting in *Everson* v. *Board of Education* (supra), argued that a purpose of the First Amendment, above all, was the "great end" of keeping "bitter religious controversy out of public life by denying to every denomination any advantage from getting control of public policy or public purse."[100] These analyses are as applicable to the statutes which the Court has struck down as to the two statutes upheld over Justices Black's and Jackson's strong dissents.

These opinions discussed the dangers of church involvement in legislative activity at a time (as at present) when most church organizations were federally tax deductible and therefore not able to engage in lobbying activity with deductible funds (funds which comprise the larger part of their budgets). The policy against religious involvement in legislative controversies would present an even greater challenge to state aid to religious schools if churches generally could lobby with deductible funds, simply because there would be more of this lobbying.

These cases do not lead to a conclusion that ending the Code's restrictions on church lobbying with deductible funds would itself be unconstitutional. These authorities suggest, however, that Congress would be well advised to consider this aspect of the entanglement doctrine before extending subsidies to church lobbying. (In any case, it seems logical that Congress should look to Supreme Court decisions for policy guidance when legislating in an area affecting religion, even though there is no constitutional command that it should do so.) The legislation presently before Congress puts off a legislative resolution of this problem by not allowing churches to elect to come within the percentage or dollar allowances for lobbying activities, although it does allow independent nondenominational religious organizations to become involved in lobbying with deductible funds.[101]

VIII

PUBLIC POLICY ISSUES

To this point, this discussion has dealt exclusively with constitutional issues involved in the charity lobbying restrictions. Chapters IV, V, and VI analyze contentions that the restrictions in the Code are unconstitutional. Chapter VII explores policy issues which relate to constitutional concerns.

This final chapter presents several points of view which generally do not relate to constitutionally protected charity activities[102] but which should be advanced against proposals to allow donors to charity lobbying activities to be eligible for deductions.

A first policy problem with deductible charity lobbying is its unfavorable impact on the tenor of debate over charitable concerns. A major argument for allowing deductions for donations to charity lobbying activities is that legislative bodies need every bit of information obtainable so as to make decisions on legislative proposals based on a full record.[103] However, charities may already make lobbying presentations to committees and members, using deductible funds, upon official request.[104] Charities may already, even when there is no official invitation, present impartial analyses and offer conclusions on issues before legislative bodies; this is considered not to be lobbying but rather to be educational activity.[105] Permitted action of this type even includes drafting and presenting model legislation.[106] If these activities are permissible under existing law, there arises the question as to how the conduct of charity involvement in the legislative process would differ after passage of liberalizing legislation.

From the point of view of the public perception of the change, the most important new development would be that charity groups would be able to testify on an uninvited basis and advocate legislative action consistent with and intrinsic to the charitable purposes for which the groups were formed. Additionally, the groups would be able to exhort their members or the general public to take individual actions for the same ends. The charity groups would no longer be required, if they wished to enter the public debate on a bill, to present an impartial analysis of the issues, or an analysis of both the advantages and disadvantages of the proposed legislation. Under some proposals for change in the lobbying restrictions, charitable organizations would be able to use deductible donations to purchase advertisements advocating their points of view on legislative issues; business interests may do this under existing Code section 162(e) but may not do so with deductible funds.[107]

Out of sight of the public at large, the charity organizations would be able to carry on lobbying activities such as "whipping" (taking steps to ensure that legislators attend key sessions and vote for a lobbyist's interest); "corridor" lobbying or "buttonholing" (maintaining a presence in hallways and anterooms in a legislature so as to have as many chances as possible to persuade legislators to accept a pro-charity view); and entertaining the legislators. Again, business interests are permitted to carry on such activities, but, under section 162(e), may not do so with deductible funds. (Some businesses probably do take deductions for such activity, however.) Even if the restrictions in section 162(e) were repealed, deductibility for such business expenditures would not constitute a subsidy (as would deductibility for charity lobbying) but rather would provide a sounder method of computation of net income.[108]

Charitable institutions exist to serve the public at large, or a portion of the public at large, and exist to carry out activities which are eleemosynary rather than activities serving pecuniary self-interests or serving only to inflate the reputations of the principals of the charitable organizations. The public has the right to ask of charitable organizations that they meet higher standards of debate than the standards prevailing in the commercial and campaign marketplaces. Accordingly, it is appropriate that the Treasury regulations require charities, when they are acting with deductible donations, to restrict themselves to "nonpartisan analysis,"[109] and the presentation of "a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion."[110] It seems reasonable that a requirement for fair analysis should be consistent with the very nature of charity. The kinds of lobbying to be permissible under some proposals – for example, charity groups using deductible donations to send out mass mailings or to purchase television advertisements which ignore reasonable arguments on the opposite side of an issue – will provide a dramatic contrast to "nonpartisan analysis." This kind of activity could diminish public confidence in charitable organizations.

Stronger examples of the kind of controversies which could impair citizen confidence in charitable organizations are provided by referenda or initiatives which arouse conflicting views within the nonprofit community itself. Under some proposals for liberalization of the lobbying rules, a scientific organization and an environmental organization could engage in public campaigns against each other's positions on nuclear power regulation. Alternatively, a pro-public-schools organization and a private-school coalition could engage in newspaper or television campaigns against each other's views on a proposed constitutional amendment allowing federal aid to nonpublic education. No side would be obliged to do more than advocate the soundness of its own position (although any side could focus primarily, instead, on the supposed dangers of the opposition's position). All sides would be carrying on their campaigns with tax subsidies. Presumably, the public would be able eventually to make a reasoned judgment on the arguments and counterarguments,[111] but one might question whether this kind of debate would increase potential donors' confidence in the charitable system.

A second policy problem relates to the independence of the charitable sector. It seems logical that the largest part of the charity lobbying which would take place, if the Code restrictions were loosened, would be lobbying – by educational, cultural, and social service organizations which operate programs for the public – to obtain government funds.[112] Increased lobbying for government funding will place new burdens on efforts to preserve the independence of private charities. Erosion of the independence of the charitable institutional sector will most affect those activities which that sector does uniquely well or which it alone can do – from, for example, engaging in controversial research to monitoring the affairs of government itself.

A third public policy problem with deductible charity lobbying is the danger that such a policy will erode the strength of the charitable institutional sector. To survive, a public charity must provide a service (for example, education) to a sufficient number of beneficiaries who can provide whatever matching fee (tuition, in this example) is necessary. Alternatively, a charity must sufficiently translate into action the altruistic impulses of donors, so the group will continue to garner enough contributions to meet its budget.[113]

The need for citizen support imposes an invigorating discipline on charitable institutions. One of the "strengths and vitalities of public giving" is that such giving reflects the shifting priorities of our society. If because of inertia or self-interest an organization does not provide the services or the goodwill which beneficiaries or donors seek, the organization will lose its private support.[114] Indeed, the private charitable sector may be judged by how effectively it meets new public needs.[115]

Nevertheless, it is understandable that the principals of an organization are reluctant to become persuaded that the task they set out to perform has priced itself beyond practicality (as some suggest private education has) or is no longer responding to a widely shared charitable impulse.[116] Instead of abandoning the charitable enterprise because of a lack of payors or donors, it is more likely that the principals will turn to the legislatures for funds.

If, in the future, citizen organizations are allowed to lobby with their deductible funds, the test for survival for such organizations may be not how well their goals reflect a strongly supported public need, but rather how adroit the principals are at currying legislative favor.[117]

Successful access to the appropriations process may shield charitable institutions from the discipline of the shifting priorities of citizen giving. When institutions can no longer interest enough citizen donors, or are offering a social service (the example of education is appropriate), however critical, at too high a fee, the institutions will seek legislative aid to continue, extending governmental controls to such institutions and perhaps ossifying them in the process.

The Commission Report describes[118] how the charitable sector changes over time. This change is characterized by government taking over services and functions, and the emergence of new focuses of nonprofit activity. Removing limitations on the ability of charitable organizations to become participants in the appropriations process may have the effect of hastening the pace of this evolution. Successful access to the appropriations process, or successful efforts to lobby the government to undertake desired activities on its own, will result in the extension of government[119] rather than in the diversification of private and citizen activity. Diversification of governmental effort is not intrinsically undesirable; however, expansion of governmental activity at the expense of the charitable sector, a trend found by the Commission to be in effect already,[120] can only increase the relative strength of government vis-a-vis that of charitable institutions, eroding the societal pluralism which is important to all citizens.

Last, the Commission has expressed its strong concern that citizens' impulses to give may be diminishing, and the Commission Report recounts some phenomena which may indicate why donor support is not keeping pace.[121]

One factor suggested by the Commission as contributing to a decline in citizen support is confusion about the overlapping roles of charity and government. Heavy involvement of charitable organizations in the lawmaking process may confuse the public even more about the activities of citizen organizations. To the extent that charitable access to the appropriation process is enhanced, the philanthropic impulse may be diluted by a perception that what individual donors do not provide, government will.

This discussion has already referred to another factor which may diminish public confidence in the charitable sector and thus erode the impulse to give: the occurrence of spirited media controversies with charity organizations on one or both sides.[122]

In the case of established charitable institutions, informed donors have made contributions for years in the knowledge that deductible contributions could not be used for lobbying purposes. Were charities allowed to lobby, however, the donee institution could take funds given when lobbying was restricted, or income from principal given when legislative activity was foreclosed, and use the funds for lobbying. Donors who made general-purpose gifts in prior years believing that such funds would not be used for lobbying, or even strongly preferring that their gifts not be used for lobbying, would see their funds diverted. This seems yet another factor that might diminish the philanthropic impulse on the part of substantial individual donors.

In the final analysis, then, there are policy reasons why charitable organizations should approach lobbying activity with restraint. Media campaigns propagandizing on one side of an issue may be perceived by the public as inconsistent with the nature of the charity. Greater access to the appropriations process poses threats to the independence and strength of the charitable sector. Government funding may shield nonprofit organizations from the healthy discipline of changing donor priorities.

All these factors, and additional concerns such as increased confusion between the roles of charity and government and the diversion of past donations to future lobbying activity, may discourage the impulse to give. Thus, from this point of view, extensive involvement by charities in the legislative area may lead not toward a stronger voluntary sector but to continued erosion of private giving itself.

Footnotes

1. This provision is in section 170(c)(2) of the Internal Revenue Code of 1954 (26 U.S.C.), the restrictive language of which also appears in Code section 501(c)(3) and in the estate and gift chapters. The restriction entered the tax law pursuant to sections 23(o)(2) and 101(6) of the Revenue Act of 1934, P.L. 73-216, Act of May 10, 1934, 48 Stat. 680, which was H.R. 7835. However, pre-1934 cases, notably *Slee v. Commissioner*, 42 F. 2d 184 (2d Cir. 1930), held that lobbying was generally outside the scope of the activities of a deductible charitable organization. All references to the Code or to statutory sections are to the Internal Revenue Code of 1954, as amended, unless otherwise stated.

2. These and other specialized terms are defined infra.

3. See, *e.g. Seasongood v. Commissioner*, 227 F.2d 907 (6th Cir. 1955); *League of Women Voters v. United States*, 180 F. Supp. 379 (Ct. Cl. 1960), cert. denied 364 U.S. 822 (1960); and *Kuper v. Commissioner*, 332 F.2d 562 (3rd Cir. 1964), cert. denied 379 U.S. 920 (1964).

4. See Clark, "The Limitation on Political Activities: A Discordant Note in the Law of Charities," 46 *Va. L. Rev.* 439 (1960); "The Sierra Club, Political Activity, and Tax Exempt Charitable Status," 55 *Geo. L.J.* 1128 (1967); Borod, "Lobbying for the Public Interest," 42 *N.Y.U. L. Rev.* 1085 (1967)); Jorling, "Information, the Tax Law and the Legislative Process," 48 *Ore. L. Rev.* 227 (1969); Hauptman, "Tax Exempt Private Educational Institutions: A Survey of the Prohibition Against Influencing Legislation and Intervening in Political Matters," 37 *Brooklyn L. Rev.* 107 (1970); Walker and Rothermel, "Political Activities and Tax Exempt Organizations Before and After the Tax Reform Act of 1969," 38 *Geo. Wash. L. Rev.* 1114 (1970); Garrett, "Federal Tax Limitations on Political Activities of Public Interest and Educational Organizations," 59 *Geo. L. J.* 561 (1971).

5. Caplin & Drysdale, Washington, D.C.

6. Troyer, "Charities, Law-Making, and the Constitution: The Validity of the Restrictions on Influencing Legislation," 31 *N.Y.U. Inst. Fed. Taxation* 1415 (1973), hereinafter "*N.Y.U.*"

7. See *Americans United, et al. v Commissioner*, 469 F.2d 1179 (D.C. Cir. 1972), *rev'd* 416 U.S. 752 (1974); *Tax Analysts and Advocates v. Schultz, dism. on jurisd. gds.* 75-1 U.S.T.C. ¶9365 (D.C. Cir. 1975); and *Taxation With Representation v. United States*, 76-2 U.S.T.C. ¶9693 (E.D. Va. 1976).

8. "Direct" lobbying connotes contacts with legislators and legislative staffs by representatives of charity (or any other petitioner). Testifying at hearings or meeting with a congressmember in private are examples of direct lobbying. "Indirect" lobbying is exemplified by mass mailings to the general public, or advertising, in an attempt to influence the public in favor of the advertiser's point of view on a legislative controversy or to convince the public to take action (favorable to the advertiser) to influence a legislative body. The distinction between direct and indirect (sometimes called "grass roots") lobbying is embodied in the Revenue Code at section 162(e).

9. In this paper, this phrase is referred to as prohibiting lobbying or as prohibiting "substantial" lobbying; however, "substantial" refers to the part of the group's program that is lobbying, rather than to the lobbying itself. For an extensive discussion of this term, see Chapter VI.

10. Cf. Rev. Rul. 54-243, 1954-1 C.B. 92.

11. There is an exception for legislative issues specifically relating to foundations' statutory attributes.

12. Two other types of charities are worth mentioning. Fraternal and veterans groups are eligible for deductible donations and for tax-exempt status, and they may lobby with their deductible donations.

13. Even lesser restrictions apply in the case of veterans and fraternal groups; donors to such groups may deduct their donations even if the groups use the proceeds for lobbying.

Veterans and fraternal charities have the least restrictions on lobbying with deductible donations. Consistent with this treatment is that such groups are less subject to control by a few individuals. Veterans and fraternal organizations have homogeneous memberships, and in the case of a fraternal group must be part of a larger national organization of fraternal lodges.

14. While this view would probably be subscribed to by a majority of fiscal theorists, there is a contrary view. See W. Andrews, "Personal Deductions in an Ideal Income Tax," 86 *Harv. L. Rev.* 309 (1972); M. Taussig, *Economic Aspects of the Personal Income Tax Treatment of Charitable Contributions* (reprinted from Volume 20 of the *National Tax Journal*), Brookings Institution, 1967, at 1 and 2; Proceedings of the Commission on Private Philanthropy and Public Needs, January 15, 1974 (remarks of Professor Boris Bittker) (mimeographed); Bittker, "Charitable Contributions: Tax Deductions or Matching Grants?" 28 *Tax L. Rev.* 37, 58-59 (1972).

15. In fact, the Revenue Code already involves departures from this net income concept in connection with lobbying. Sections 170(c)(3) and (4), and 501(c)(19) and (10), respectively, allow deductible contributions to, and tax-exempt investment income for, veterans and fraternal lobbying groups. Section 501(c)(4) allows tax-exempt investment income for social welfare lobbying groups. These provisions all subsidize charity lobbying efforts. Section 162(e), which disallows business deductions for indirect lobbying, penalizes business lobbying efforts.

16. See the articles and plaintiffs' pleadings cited in notes 4, 6 and 7, supra.

17. Van Alstyne, "The Demise of the Right-Privilege Distinction in Constitutional Law," 81 *Harv. L. Rev.* 1439 (1968).

18. *Frost v. Railroad Commission,* 271 U.S. 583, 593-594 (1926).

19. 81 *Harv. L. Rev.* 1445-46.

20. Ibid., at 1447.

21. Ibid., at 1448.

22. *N.Y.U.* at 1429-30.

23. *Civil Service Comm'n v. Nat'l Ass'n of Letter Carriers,* 413 U.S. 548 (1973).

24. *United Public Workers v. Mitchell,* 330 U.S. 75 (1947).

25. 81 *Harv. L. Rev.* 1446-47, 1448-49.

26. *N.Y.U.*, at 1427.

27. Rev. Rul. 54-243, 1954-1 C. B. 92.

28. *Slee v. Commissioner,* 42 F.2d 184, 185 (2d Cir. 1930).

29. Ibid.

30. *Cammarano v. United States,* 358 U.S. 498, 513 (1959).

31. 358 U.S. at 508, 512.

32. Treas. Reg. 33, Art. 143 (1918) and successor provisions.

33. E.g., N.Y.U. at 1451 ff.; Amended Complaint, *Tax Analysts and Advocates* v. *Shultz*, 75-1 USTC ¶9365 (D.C. Cir. 1975).

34. Workers making payments to labor unions are granted deductions for such payments because they are ordinary and necessary business expenses.

35. *Johnson* v. *Robison*, 415 U.S. 361, 364 n. 4 (1974). This formulation is broader than the statement of the same principle in *Bolling* v. *Sharpe*, 347 U.S. 497, 499 (1954). See also *United States Department of Agriculture* v. *Moreno*, 413 U.S. 528, 533 (1973), referring to "the equal protection component of the Due Process Clause of the Fifth Amendment." Compare *Detroit Bank* v. *United States*, 317 U.S. 329, 337 (1943); "Unlike the Fourteenth Amendment, the Fifth contains no equal protection clause and it provides no guaranty against discriminatory legislation by Congress."

36. *A. Magnano Co.* v. *Hamilton*, 292 U.S. 40, 44 (1934); *Tyler* v. *United States*, 281 U.S. 497, 504 (1930); *Brushaber* v. *Union Pacific Railroad Co.*, 240 U.S. 1, 24-25 (1916).

37. These three quotations appear, successively, at the references cited in the previous footnote.

38. Mertens *Law of Federal Income Taxation* §4.01. *Eisner* v. *Macomber*, 252 U.S. 189 (1920) was not a due process case.

39. *United States* v. *Maryland Savings-Share Ins. Corp.*, 400 U.S. 4 (1970) (per curiam).

40. 400 U.S. at 6.

41. 358 U.S. 498 (1959).

42. 358 U.S. at 508, 512, 513.

43. In fact, these distinctions were part of the Code when the *Cammarano* Court held the Code's lobbying provisions to be nondiscriminatory.

Veterans organizations aid active and veteran members of the armed forces and carry on patriotic activities, as permitted under Prop. Reg. Section 1.501(c)(19)-1(c). Such groups have many of the attributes of fraternal organizations. Lobbying by such groups is less likely to reflect personal-choice concerns. In any case, nontax provisions of the U.S. Code embody some restrictions on veterans organizations' lobbying. See Act of September 6, 1919, chap. 59, 41 Stat. 284, 285, section 6; Act of August 27, 1958, P.L. 85-769, 72 Stat. 922, 926, section 10; Act of August 26, 1958, P.L. 85-761, 72 Stat. 854, 858, section 10; Act of July 23, 1947, chap. 298, 61 Stat. 403, 406, section 5. For tax restrictions on lobbying, see Sen. Rep. No. 1082, 92d Cong., 2d Sess. 5 (1972). Veterans organizations' concerns are consistently supportive of "national security," and a congressional intention to subsidize such organizations is likely to be respected by the courts. Additionally, [illegible] consistent concern of veterans organizations is the enhancement of veterans' benefits. Under the view that such benefits are compensation for military service, veterans' donations for lobbying for such benefits are not really charitable donations but rather donations to a trade association.

Fraternal organizations are actually required to have members who are committed to a common goal. *Phila. & Reading Relief Association*, 4 B.T.A. 713, 725 (1926). Code section 170(c)(4) also requires such organizations to operate "under the lodge system," involving a national chapter and at least one other chapter. These requirements indicate that lobbying by fraternal groups will be more insulated from the personal-choice concerns of individual members than conventional charities.

44. *Shapiro* v. *Thompson*, 394 U.S. 618, 638 (1968).

45. In *Moritz* v. *Commissioner*, 469 F.2d 466 (10th Cir. 1972), a deduction allowed, in effect, only to females was extended to males on the basis of sex classification being "suspect and invidious."

46. *"Americans United," Inc.* v. *Walters*, 477 F.2d 1169 (D.C. Cir. 1973), rev'd 416 U.S. 752 (1974).

47. *San Antonio Independent School District* v. *Rodriguez*, 411 U.S. 1 (1973).

48. 411 U.S. at 20-22.

49. *Connally* v. *General Construction Company*, 269 U.S. 385, 391 (1926).

50. Amsterdam, "The Void-for-Vagueness Doctrine in the Supreme Court," 109 *U. Pa. L. Rev.* 67 (1960).

51. *NYU*, at 1456-1462.

52. Amsterdam, op. cit., at 83-91.

53. *United States* v. *Harriss*, 347 U.S. 612 (1954); *United States* v. *Rumely*, 345 U.S. 41 (1953); and see *Buckley* v. *Valeo*, 424 U.S. 1, 76-82, (1976), construing a statute (and, as construed, upholding it) containing the phrase "for the purpose of . . . influencing" nominations or elections, in the context of a vagueness attack.

54. *Christian Echoes National Ministry, Inc.* v. *United States*, 470 F.2d 849, 855, 856 (10th Cir. 1972), cert. denied, 414 U.S. 864 (1973).

55. *Kuper* v. *Commissioner*, 22 T.C.M. 1206 (1963), aff'd 332 F.2d 562 (3d Cir. 1964), cert. denied 379 U.S. 920 (1964); *League of Women Voters* v. *United States*, 180 F. Supp. 379 (Ct. Cl. 1960), cert. denied 364 U.S. 822 (1960).

56. *Seasongood* v. *Commissioner*, 227 F.2d 907 (6th Cir. 1955); *Huntington Nat'l Bank* v. *Commissioner*, 13 T.C. 760, 769 (1949).

57. *Liberty National Bank & Trust Co.* v. *United States*, 122 F. Supp. 759, 762, 766 (W.D. Ky. 1954).

58. A minor role of the "substantial" test is merely to provide a *de minimus* rule to exculpate unintentional or incidental violations. In this role, the word is designed to diminish enforcement frictions brought about by speech activities.

59. *Harriss*, 347 U.S. at 622. Thus the Supreme Court, in upholding the Lobbying Act in the face of a vagueness attack, defined it by the use of the terms "substantial part" and "influencing legislation." The Lobbying Act also regulates contributions "of value" but not "merely" appearances to testify. 2 U.S.C. sections 261 and 267(a).

60. *Civil Service Commission* v. *Nat'l Ass'n of Letter Carriers*, 413 U.S. 548 (1973).

61. 5 U.S.C. section 7324(a).

62. 346 F. Supp. 578 (1972)

63. Ibid., at 584 and notes 12 and 13.

64. 5 U.S.C. section 7324(a)(2).

65. 5 U.S.C. section 7326(2).

66. See 413 U.S. at 582, Appendix III (12).

67. See 413 U.S. at 572, note 18 at (13).

68. 5 C.F.R. part 733, section 733.111(a)(13).

69. In explaining the scope of the prohibitions of the act, the Court stated that "it is essential that federal employees not, for example,. . . undertake to play substantial roles in partisan political campaigns . . ." 413 U.S. at 565.

70. *United States v. Whyel et al.*, 19 F.2d 260 (W.D. Pa. 1927), *aff'd on other grounds*, 28 F.2d 30 (3rd Cir. 1928); government's petition for cert. dismissed on government's motion, 278 U.S. 664 (1929).

71. *Newman v. Piggie Park Enterprises*, 256 F. Supp. 941 (D.S.C. 1966), modified on other grounds, 377 F.2d 433 (4th Cir. 1967), 390 U.S. 400 (1968).

72. 42 U.S.C. 2000a(c)(2).

73. 256 F. Supp. at 944.

74. Ibid., at 950, 951.

75. One case concerns the term "real": in *International Harvester Co. v. Kentucky*, 234 U.S. 216 (1914), the term "real value" was held defectively vague, but this use of the term "real" was in the sense of "free market price" in a factual situation where there was no free market. The term was not used in the sense of "real" value as opposed to "no" value, which is the sense in which "real" may be synonymous with "substantial." In any case, at present under Code section 2031 and comparable statutes, courts routinely determine real value where there is no single dispositive index of such value, so whether *International Harvester* would be decided the same way today is questionable.

76. E.g., *U.S. v. North Carolina Granite Corp.*, 288 F.2d 232 (4th Cir. 1961).

77. *Sherar v. United States*, 413 F.2d 986 (9th Cir. 1969); *Price v. Flemming*, 280 F.2d 956 (3rd Cir. 1960); and *Trenton Cotton Oil Corp. v. Commissioner*, 148 F.2d 208 (6th Cir. 1945).

78. *Anderson v. Manhattan Lighterage Corp.*, 148 F.2d 971 (2nd Cir. 1945), and *Anuchick v. Transamerican Freight Lines*, 46 F. Supp. 861 (E. D. Mich. 1942).

79. *Uinta Livestock Corp. v. United States*, 355 F.2d 761 (10th Cir. 1966); *Bodell v. Commissioner*, 154 F.2d 407 (1st Cir. 1946); and *Anderson v. Manhattan Lighterage Corp.*, 148 F.2d 971 (2nd Cir. 1945).

80. *Commissioner v. Zongker*, 334 F.2d 44 (10th Cir. 1964); *United States v. Pawlak*, 352 F. Supp. 794 (S.D.N.Y. 1972).

81. According to a computer-generated listing prepared for the National Office of the IRS.

82. The amount of the standard deduction probably has some relation to the average amounts of potential itemized deductions, so there may be a sense in which a "shadow" charitable deduction is available to standard deductors. For example, if the charitable deduction were available as a deduction from gross income, the standard deduction might be reduced, partly in recognition of the fact that after both statutory changes, many standard deduction families will be no worse off than before the two changes in the law.

83. Such families can only receive tax subsidies when tax credits are "refundable" as was, for example, the Earned Income Credit available pursuant to the Tax Reduction Act of 1975.

84. Subject to the limitations on the charitable deduction as a percentage of, generally, adjusted gross income, contained in Code section 170 and the regulations thereunder.

85. On the other hand, the value to the donor of the marginal dollar of subsidy declines with wealth, so the marginal value of ever-larger (in dollar terms) subsidies may be level or decreasing in relation to wealth. Furthermore, in terms of tax rate reduction, the wealthier the taxpayer, the smaller the reduction in effective rate. These are counterarguments to the "upside down" contentions concerning charitable (and other) deductions.

86. *Tax Analysts and Advocates v. Shultz*, 376 F. Supp. 889, 898-899 (1974), injunction vacated as moot 75-1 U.S.T.C. ¶13,052 (D.C. Cir. 1975) (per curiam).

87. *San Antonio Independent School District v. Rodriquez*, 411 U.S. 1, 20-22 (1973).

88. E.g., *Griffin* v. *Illinois*, 351 U.S. 12 (1956).

89. *Douglas* v. *California*, 372 U.S. 353 (1963).

90. E.g., *Williams* v. *Illinois*, 399 U.S. 235 (1970).

91. *Bullock* v. *Carter*, 405 U.S. 134 (1972).

92. *Griffin, Douglas* and *Williams*, op. cit.

93. *Bullock* v. *Carter*, op. cit.

94. Congress may have become more cognizant of this problem in the last few years. The addition of section 4945 to the Revenue Code, in 1969, is certainly an effort to deny tax subsidies to wealthy donors to lobbying activities. A more systematic approach for "equalizing" tax subsidies for First Amendment protected activities, however, is embodied in Code sections 41 and 218, added by the Revenue Act of 1971, which presently allow, alternatively, a tax credit of up to $25 ($50 in the case of a joint return) for half of an individual's campaign contributions, or a deductions of up to $100 ($200 in the case of a joint return) for such contributions. The credit is nonrefundable, so the poor do not benefit from these provisions. Middle-income and affluent taxpayers benefit proportionally in relation to their wealth, with tax subsidies ranging up to $70 for an individual in the highest income bracket. Congress long resisted tax subsidies for donations to political campaigns. Now that Congress has seen fit to grant such tax benefits, it is doing so in a way that more nearly awards equal benefits regardless of income class. This system provides a complete contrast to a provision for deductions for contributions to the lobbying campaigns of charities and would amply rebut any argument, in defense of such a charitable contribution deduction, that no less restrictive statutory scheme is available to subsidize the First Amendment protected activities of charities and their donors.

95. *Lemon* v. *Kurtzman*, 403 U.S. 602, 625 (1971).

96. Ibid., at 622-23.

97. *Committee for Public Education* v. *Nyquist*, 413 U.S. 756 (1973).

98. Ibid., at 794-798. For additional formulations of this ban on the interference of either institution into the affairs of the other, see *Everson* v. *Board of Education*, 330 U.S. 1, 15, 16, (1974), a decision which, however, upheld a statute authorizing reimbursements for bus fares of parochial school students.

99. *Board of Education* v. *Allen*, 392 U.S. 236, 251 (1968).

100. *Everson*, op cit., at 27.

101. However, sectarian organizations (other than corporations) which eschew deductible contributions, tax exemptions, and other governmental benefits are already free to engage in lobbying and campaigning to an unlimited extent.

102. These points of view relate to the nature and health of the charitable sector generally.

103. *N.Y.U.*, at 1431, quoting Sen. Rep. No. 1881, 87th Cong., 2d Sess. 22 (1962).

104. Cf. Rev. Rul. 70-449, 1970-2 C.B. 111.

105. Cf. Reg. §§1.501(c)(3)-1(c)(3)(iv) and 1(d)(3)(i)(b); Rev. Rul. 64-195, 1964-2 C.B. 138.

106. Rev. Rul 64-195, op cit.

107. There is speculation that businesses do take deductions for much such advertising. See U.S. Senate Committee on Finance, "Energy and Environmental Objectives," Hearings, 93rd Cong. 2d Sess. (1974); *N.Y.U.* at 1432-34.

108. See Chapter III.

109. Reg. §1.501(c)(3)-1(c)(3)(iv).

110. Reg. §1.501(c)(3)-1(d)(3)(i)(b).

111. One of the allegations likely to be made would be that the other side's media campaign was being financed with private foundation grants. Under some proposals for loosening the lobbying restrictions, public charities could use general purpose foundation grants as a source of funds for lobbying unless the terms of the grant entirely forbade use of the funds for lobbying. If the grant forbade all but insubstantial lobbying, then under some proposals the money could be used for lobbying within proportional dollar limits. The possibility of such allegations receiving widespread publicity does not seem likely to enhance the public standing of the foundation community.

112. At present, such lobbying is restricted to the executive branch or takes place only pursuant to invitations from legislative bodies.

113. These generalizations do not apply in the same way to private foundations.

114. See *Giving in America: Toward a Stronger Voluntary Sector*, Report of the Commission on Private Philanthropy and Public Needs, 1975 (hereinafter cited as "Report"), at 75, 121.

115. See Ibid., at 33.

116. Alternatively, the principals of a charity may simply feel they are only receiving a minimum of funds from the public; they may feel that more money is needed to carry out their specific charitable aim.

117. On the other hand, support from government is support from the public, and legislators would presumably not long support projects for which there was little public support. Restrictions currently allow citizen organizations to curry executive favor for budgetary support; the logical extension of the argument set forth in the text would be to bar citizen groups from access to the executive branch as well as to the legislative branch.

118. Report, at 40-41.

119. Albeit, perhaps, its diversification.

120. See Report, Chapter IV.

121. Report, at 71-75.

122. On the other hand, it may be that more vigorous public charity activity along these lines will attract more donations than it would discourage.

Part II

Foreign Practices

OVERVIEW OF GOVERNMENTAL SUPPORT AND FINANCIAL REGULATION OF PHILANTHROPIC ORGANIZATIONS IN SELECTED NATIONS

Arthur Andersen & Co.

Introduction

This report provides a broad overview of the support and financial regulation of public philanthropic organizations by the governments of eight industrialized nations. The nations selected by the staff of the Commission on Private Philanthropy and Public Needs for study were Australia, Canada, England, France, West Germany, Italy, Japan, and Sweden. The questions that they requested be addressed are as follows:

1. Does the government provide tax incentives for individuals and businesses to contribute to charities? If so, do the incentives apply to contributions made during an individual's lifetime? Do they apply to bequests? Are the incentives in the form of tax credits, deductions allowed in arriving at taxable income, or specified income exemptions?
2. Does the government have a program under which it matches, in the form of grants, all or part of certain contributions to specified private charities?
3. Does the government provide financial aid to private charities in any form other than those described above?
4. Are private charitable organizations exempt from income, property and/or other taxes?
5. What methods and/or agencies are used by the government to regulate the financial aspects of philanthropic organizations?
6. What special rules, if any, exist relative to tax incentives pertaining to religious organizations?

We found that direct and indirect governmental support of the private philanthropic sector varies inversely with the involvement of government itself in providing social services. For example, direct government grants as well as tax incentives for private giving are significant in Australia, while such suport is extremely limited in Sweden. While the forms of government support vary, none of the selected countries has a general program for matching private giving with government grants.

We also found that governmental supervision and regulation of private charitable organizations exists to some degree in all of the countries, with particular emphasis on organizations receiving direct governmental grants. Japan, in particular, has a comprehensive program for monitoring the financial and charitable activities of charities.

The tax incentives available to charities and their contributors are generally also available to religious groups. However, direct government support is not given these groups except in Sweden and Germany. Governmental regulation of religious groups is limited in most cases.

The following chart summarizes our findings by country. While the regulations are complex in many cases and exceptions exist in several areas, the indicated status reflects the substance of the regulations at the time of our review. The remainder of the paper describes briefly for each of the eight countries the forms and type of governmental support and financial regulation of philanthropic organizations.

Overview of Governmental Support and Financial Regulation of Philanthropic Organizations

	Australia	Canada	England	France	West Germany	Italy	Japan	Sweden
1. Tax incentives provided for								
Individual contributions	Yes	Yes	Limited	Yes	Yes	No	Yes	No
Business contributions	Yes	Yes	Limited unless business related	Yes	Yes	Yes	Yes	No
Charitable bequests	Yes	Yes	Limited	No	Yes	Yes	Yes	No
2. Government program for matching private gifts	Occasional	No	No	No	No	No	No	No
3. Other forms of governmental support available	Grants	Grants	Grants to a limited number of charities	Grants	Grants	Grants	Subsidies and loans	Subsidies and grants
4. Organizations exempt from								
Income taxes on								
Charity-related income	Yes	Yes	Yes	Yes	Yes	Partial	Yes	Yes
Unrelated income	Yes	Yes	No	No	No	Partial	Partial	Partial
Property taxes	Yes	Varies by province	Partial	No	Yes	None	Yes	Yes
Other taxes	Yes	No	Partial	Partial	Partial	Partial	Yes	No
5. Governmental supervision	Limited to grant recipients	Registration necessary for deductibility of contributions	Charity Commission with broad authority	Limited to initial registration and financial controls	Supervision limited to grant recipients; periodic review of tax-exempt qualifications	Governmental review of donations and property transactions	Annual reports of budgeted and actual financial and program activities	Limited to grant recipients
Financial statements required	Yes Audited	Yes Audited	Yes	Yes	No	Yes	Yes Audited	Yes

Note: The status shown in this chart reflects the substance of existing regulations at the time it was prepared. Exceptions exist in certain cases.

I

AUSTRALIA

Scope of Activities of Private Philanthropic Organizations

Private charitable activities in Australia encompass the following:

1. Relief to the disabled, which includes the blind, the deaf and dumb, spastic and mentally handicapped.
2. Relief to the poor, which includes homes for the aged, assistance with food and clothing, and homes for homeless men.
3. Education, which includes pre-school, primary, secondary and tertiary education, and in particular the provision of funds for educational buildings and equipment.
4. Private and public hospitals.
5. Child welfare, which includes boys' and girls' homes and child care centers.
6. Overseas aid.
7. Youth and life-saving activities.
8. Medical research.
9. Assistance to war veterans.

Australia does not presently have extensive government operated social welfare programs, as is the case in several European countries. Genuine private charitable social welfare activities are supported by government, rather than such activities being supplementary to government programs. Accordingly, the majority of social programs are conducted by nonprofit, private sector charitable organizations.

Tax Incentives

The government provides tax incentives for both individuals and businesses to contribute to resident charities. Incentives for such contributions during an individual's lifetime are in the form of a deduction in arriving at taxable income. Incentives for businesses are also in the form of deductions from taxable income. A deduction is allowable under a specific provision of the income tax legislation where the contribution is for "public charitable purposes." These deductions are not limited to a specific percentage of taxable income. Contributions which may not come within the broad categorization of "for public charitable purposes" are, however, normally allowable as an ordinary expense deduction to business organizations.

A further incentive is granted in the form of a deduction, for death duty purposes, from the estate of a deceased person of bequests made for public charitable purposes.

Matching Grant Programs

The government does not have a general matching grant program under which it matches contributions to charitable organizations. There have been instances, however, where such a matching program has been implemented.

Financing of Charities

Other than through tax incentives, the government finances charities by the following methods:

1. Directly by government departments upon application by the charitable organization. The application, which is made for a specified sum, is considered by the department and a grant is then made according to what the department considers reasonable in the circumstances.
2. Directly by government departments without application by the charitable organization. In these cases, the grant is made by the government department as a matter of course. Such grants, which are generally for the care of wards of the State, are made on a per capita basis directly to the organization caring for the children.
3. The government provides funds to the Hospital and Charities Commission, which is an organization established to administer public funds provided for various charitable organizations. Grants are made upon assessment by the commission of applications to it by the charitable organizations. The grants available fall into two categories: maintenance grants for the everyday running of an organization, and capital grants for the financing of equipment and building projects.

Taxation of Charitable Organizations

Charitable organizations are exempt from the following taxes: (1) income tax, irrespective of the source or nature of such income; (2) payroll tax; (3) sales tax in respect of goods purchased for use and not resale; (4) property taxes, referred to in Australia as "rates and land taxes"; and (5) stamp duties on otherwise dutiable transactions (such as checks, leases).

Administrative and Governmental Control

Government (federal and state) supervision of private charities is largely limited to charities receiving grants from a government department. This supervision is directed towards assuring that the grants were spent for the purpose specified. The Hospital and Charities Commission administers the grants it makes to charitable organizations and the specific government departments administer the grants they make in their respective fields of welfare.

Organizations receiving grants for operating subsidies are generally required to submit audited income statements to the administering body in support of grant expenditures. Grants made for major building projects are directly controlled by the grantor, that is, review of contractor's invoices, progress reports, and so forth.

Charities conducted through an incorporated body are required to have an annual audit, file financial statements with the State Government Companies Registry, file a tax return, and follow accounting and reporting policies contained in the State Companies Act.

Unincorporated charities, not receiving government grants, are required only to file an annual federal tax return.

Special Rules Applicable to Religious Groups

The income of a religious group is exempt under a specific provision of the income tax legislation. Such groups are also exempt from payroll tax, property taxes, sales tax, and stamp duties.

A religious group does not receive any financial assistance from the government where the funds are for the purpose of promoting that religion. However, religious groups which operate various charitable organizations are entitled to the government assistance provided for those charitable purposes.

II

CANADA

Scope of Activities of Private Philanthropic Organizations

Canada does not have a highly developed government sponsored social welfare program. Accordingly, the scope of activities of private charitable entities is similar to that of comparable entities operating in the United States. Activities include cultural, charitable, educational, and religious groups on both the national and local level.

Tax Incentives

In Canada the government provides tax incentives for individuals and corporations to contribute to charities by allowing these taxpayers to deduct from taxable income contributions made to registered Canadian charitable organizations and certain other institutions. Deductions are permitted to a maximum of 20 percent of net income for the year, if receipts containing the prescribed information are filed with the tax return. If the taxpayer has excess donations which are not deductible in the current year, he is allowed to carry forward this excess for one taxation year. In lieu of itemizing his deductions the individual taxpayer may claim a standard deduction of $100 for which no receipts need be filed.

The tax system is also favorable to taxpayers who make charitable bequests upon death. The provincial governments have their own succession duty taxes which vary considerably. However, they generally allow charitable bequests to be deducted in computing succession duties. For example, in Ontario, property bequeathed to a religious, charitable, or educational organization working solely in Canada is not taxed or included in the value of the estate. However, the Province of British Columbia has very narrow exemptions in that the exemption limits the value of the gift to a charitable organization which qualifies under the Federal Income Tax Act to 10 percent of the net value of all property passing on the individual's death. In Ontario there is no restriction as to the percentage of the estate that is contributed to the charitable organization, that is, the entire contribution is tax exempt.

The Income Tax Act (Canada) allows a charitable gift by will to be deducted from the taxpayer's income in the year of death, equal to the amount of earned income for the taxation year.

Matching Grant Programs

The provincial and federal governments do not have matching grant programs under which the governments match private contributions to charitable organizations.

Financing of Charities

The governments make grants under statutory authority to voluntary organizations, agencies, and foundations. Certain sections of the Municipal Act enable municipalities to make grants to charitable institutions and patriotic organizations and to other groups and organizations for a variety of purposes, among them community recreation programs and facilities, health or community centers, aiding indigent persons, cultural and athletic activities, and the promotion of military science. Organizations need not be incorporated to apply, unless they are collecting funds for distribution to other groups.

Taxation of Charitable Organizations

The Income Tax Act provides for the exemption from tax of the income of charitable organizations, nonprofit corporations and charitable trusts. The groups whose activities are exclusively of a charitable nature may apply for registration as a charitable organization under the Canada Income Tax Act. These organizations do not have to be registered in order to be tax exempt, but registration is necessary if the contributor is to obtain a deduction for his contributions to the organization. Charitable organizations are generally exempt from property tax but this may vary among the provinces since property taxes are legislated by provincial statutes.

Administrative and Governmental Control

The governing body responsible for administering the tax laws for charitable organizations is the Charitable and Non-Profit Organizations Section of Revenue Canada, Taxation. It is to this department that application for registration is made. The requirements placed on charitable organizations for registration are that application for registration must include the most recent financial statements, a copy of the incorporation document, a statement of aims and objectives, and details of the organization's structure. All organizations are subject to revocation of registration if the organization ceases to comply with the requirements, fails to file an information return, issues an invalid receipt, or fails to keep adequate books and records.

In addition, the organization is required to maintain duplicates of donation receipts issued as well as have available for inspection sufficient records to enable the donation receipts and disbursements to be verified.

A completed Return of Information (Form 72052) accompanied by a copy of the financial statements for the period must be filed within three months from the end of each fiscal period of each registered Canadian charitable organization. Failure to comply may also result in revocation of registration.

In Canada at present there is very little provided under the Canada Corporations Act in requirements as to the form and content of financial statements or financial disclosure with respect to charitable organizations. However, the applicable provisions make it mandatory to keep proper accounting records and to appoint an auditor. An annual audit, leading to an auditor's report, of the organization's financial statements must be carried out.

Special Rules Applicable to Religious Groups

In Canada there are no specific tax laws relating to religious groups. However, the Income Tax Act exempts members of religious orders from paying income tax on their earned income if a vow of perpetual poverty has been taken and the member has paid this income to the order. Religious orders would be subject to the same regulations as charitable organizations since religion falls under one of the broadly categorized headings of charitable organizations.

III

ENGLAND

Scope of Activities of Private Philanthropic Organizations

England operates a "welfare state" in which medical, housing, unemployment, sporting and recreational benefits are provided to at least a basic level by the government. Therefore, government expenditures for these benefits are substantially in excess of the expenditures by charitable entities.

The law relating to institutions, and the procedures for administering charities, is embodied in the Charities Act of 1960. This act confirmed a body of Charity Commissioners for England and Wales to have authority over the registration and control of all organizations seeking and obtaining charitable status.

In order to qualify for the tax and other benefits afforded to charities, an organization must register with the Charity Commissioners and its objectives must fall exclusively within one of the following: (1) the relief of poverty, (2) the advancement of education, (3) the advancement of religion, (4) other purposes beneficial to the community.

There are over 107,000 registered charities. No reliable figures exist, but it is estimated that the total income of these charities is in excess of £150 million ($360 million) each year and that the total of investments owned by them approximates £2,000 million ($4,800 million).

Charities may raise funds in any legal manner, but in practice the major sources are investment income, direct donations, deeds of covenant, and street collections.

Tax Incentives

Income tax and corporation tax. In general, charitable contributions are not deductible for individual income and corporation tax purposes. Business profits may be reduced, for tax purposes, by contributions which are wholly and exclusively for the purposes of the business. This does not have wide application because the test restricts the type of charity to one closely connected with and capable of benefiting the business.

Limited tax relief is available by use of the deed of covenant (a legally enforceable agreement to give away a portion of future income) and this is a widely used means of raising funds. An individual or corporation may undertake to make contributions by this method, which in effect constitutes a deduction of the payment from taxable income. To be valid, a deed must be for a period capable of exceeding six years and pure income in the hands of the recipient. Payments to charity are treated as income from which tax has been deducted at the basic rate income tax. The deed of covenant provides an individual with tax relief at only the basic rate of income tax (33 percent for 1974-75). No relief is available for covenanted contributions against higher rate tax, the rate of which extends up to 98 percent. Contributions by a corporation are treated in a similar manner to those made by an individual. A net amount is paid to the charity and the tax deducted at basic rate is paid over to the Inland Revenue. The gross payment is deductible from the corporation's profits.

Gift of assets: capital gains tax and estate duty. The gift, or the sale for a consideration not in excess of its base cost, of an asset to a charity is exempt from capital gains tax.

A gift made to charity more than one year before death is exempt from estate duty. Gifts made within one year of death or bequeathed on death are exempt from duty, provided the total does not exceed £50,000. Any excess over £50,000 will be the object of an estate duty charge.

The government has introduced a finance bill to replace the estate duty with a capital transfer tax in order to include lifetime gifts. In general, similar reliefs will be available under the proposed capital transfer tax as for estate duty, but the details will not be finalized until the bill becomes law.

Matching Grant Programs

The government has no programs for matching private contributions to charities.

Financing of Charities

The government makes grants to specific major charities, for example, British Museum, but does not generally provide financial support to charities.

Taxation of Charitable Organizations

Charities are in some measure exempt from the majority of direct and indirect taxes provided the income or gains are applied for charitable purposes. The primary taxes concerned and the degree of charitable exemption available are as follows:

Income tax and corporation tax. A charitable body is exempt from income tax and corporation tax on most sources of income. The exemption extends to trading income, but only when the trade is exercised in the course of actually carrying out a primary purpose of the charity or the work involved is carried out by the beneficiaries of the charity.

Capital gains tax. No gain accruing to a charity is a taxable gain provided it is applicable and applied to charitable purposes.

Real estate tax. The general rate levied on the occupier of property in the United Kingdom is reduced with respect to property occupied by a charity to one half of the amount otherwise payable. Rating authorities have discretionary powers to reduce in part or totally the balance of the rate that may be payable.

Value added tax. Value added tax is levied at a rate of 8 percent on the supply of goods or services in the United Kingdom. There is no general exemption from this tax for charities.

Administrative and Governmental Control

Applications for charitable status and the regulation of charities is controlled by the Charity Commissioners. It is the responsibility of the trustees of a charity to ensure that all of its acts fall within the confines of the trust deed and conform with the provisions of the Charities Act. The commissioners have the power under the act to advise the trustees on any matter affecting the charity and to investigate and check any abuses. In addition, the Inland Revenue reviews the tax status of charities and ensures that the property giving use to the income and gains is owned by the charity and that the income qualifies for tax exemption and is applied solely for charitable purposes.

Financial reporting. There is a general obligation on the trustees of a charity to keep proper books of account and to prepare, for consecutive periods of not more than 15 months duration, accounts which must consist of an income and expenditure account and a balance sheet. There is no general requirement that accounts be professionally audited or published. The commissioners may order at their own expense a professional audit to be carried out for such period as they consider necessary. The accounts must be transmitted to the Charity Commissioners by the charity trustees on request. Charities with a permanent endowment are obliged to submit accounts annually to the commissioners.

Other regulatory techniques. There are extensive powers under the act which empower the commissioners to institute inquiries into a charity or class of charity, either generally or for particular purposes. In this connection, the commissioners may require any person to furnish accounts and statements on any relevant matter and to produce relevant documents in that person's custody or control.

Where the commissioners are satisfied after such inquiry that there has been misconduct or mismanagement in the administration of a charity and that action must be taken to protect the property of the charity or properly apply its funds, they may take such action as they consider appropriate within the limits of the act.

Special Rules Applicable to Religious Groups

There are no special rules for religious groups, which usually qualify as charities and are treated in the same way as other charities.

IV

FRANCE

Scope of Activities of Private Philanthropic Organizations

As a consequence of the highly developed, state-sponsored social welfare programs, charitable institutions operating in France have a much more limited scope of activities than comparable entities operating in the United States.

The two types of charitable institutions operating in France are the *association reconne d'utilite publique* and the *fondation*. The principal activities of these entities are (1) relief for the poor, (2) relief for aged persons, (3) health (including hospitals), (4) charity and other social activities, (5) research in intellectual, medical, scientific fields, (6) teaching, and (7) museums and cultural activities.

Tax Incentives

The government makes available tax incentives for contributors to such entities in the form of expense deductions in arriving at taxable income. For individuals such deductions are limited to from 0.5 percent to 1 percent of taxable income. For business entities or individuals carrying on commercial activities such deductions are limited to from 0.1 percent to 0.3 percent of sales. These incentives generally do not apply to charitable bequests.

Matching Grant Programs

The government does not provide a grant program under which private contributions to charitable organizations are matched.

Financing of Charities

Cash grants may be obtained from the government by private charitable institutions upon request. In 1969, a special foundation called the *Fondation de France* was created by the government to receive charitable contributions from the public and to redistribute the money collected to other existing charitable institutions.

Taxation of Charitable Organizations

The revenues of charitable institutions are normally exempt from French corporate income tax. However, the corporate income tax is applied at the special rate of 24 percent on rent income, agricultural income, and certain interest and dividend income of charitable institutions. Moreover, if the charitable institution organizes operations for which the intention is deemed more commercial than philanthropic, and if such activity is not directly connected with the purpose of the institution, the profit may be taxed at the normal corporate income tax rate of 50 percent.

Property taxes are generally applicable to charitable institutions. Registration taxes on charitable gifts are generally reduced or not applicable, while such taxes on the purchase of buildings are generally reduced. The business license tax is normally not payable by such institutions, except if the activity is deemed commercial and if the normal corporate income tax is applicable. Depending on the nature of the activity and the purpose of the charitable institution, the tax on value added may be applicable.

Administrative and Governmental Control

Foundations as well as associations are private institutions managed by the foundators (foundations) or committee members (associations). No administrative or governmental agencies are used as such to supervise these institutions. However, certain controls are exercised at inception by the government, represented by the *Ministere de l'Interieur*.

Financial reports must be submitted on an annual basis to the *Ministere de l'Interieur* by the foundations or associations. A yearly tax return must also be submitted to the Tax Administration.

Special Rules Applicable to Religious Groups

Two different types of religious groups exist in France, the *congregation* and the *association cultuelle*. The *congregation* is a special association for a group of members exercising the religious profession. In order to have a legal existence, the *congregation* has to be authorized by a governmental agreement in the form of a decree signed by the Administrative Supreme Court. Yearly financial statements must be submitted. These entities are subject to the same French corporate income tax rules as other charitable institutions.

Associations cultuelles are institutions created in accordance with the 1905 law providing for the full independence of the State and the Church. This type of organization is used by Protestants, Catholics, Jews, and Mohammedans. The objectives, which are strictly limited, of such organizations are to deal with any administrative and financial problems of the various religious bodies. The major part of their revenues is from public collections. The receiving of gifts or bequests is generally prohibited except if it is deemed to contribute to the strict objective of the association. From a tax viewpoint, there are no property taxes if the buildings used for public worship are owned by public collectivities (State or cities).

Compulsory yearly financial statements prepared on the cash basis of accounting are required by the *Ministere de l'Economie et des Finances*.

V

WEST GERMANY

Scope of Activities of Private Philanthropic Organizations

German social security laws, which cover the majority of the population, provide for assistance in case of sickness, unemployment, disability, and retirement, as well as for the payment of medical expenses. Those not insured under the Social Security System are legally entitled to social welfare payments financed by governmental boards. Social welfare payments, however, do not exceed a level regarded to be the minimum to maintain human dignity.

Under these circumstances the activities of private charities are primarily directed toward subsidizing public services that are not sufficiently provided for by federal, state, and municipal authorities. Thus, private charitable organizations finance or co-finance the construction and running costs of hospitals and convalescent homes, old peoples' homes and nursing centers, vacation homes for mothers with many children, kindergartens and rehabilitation centers. They also render advice and practical help to people who have difficulties being integrated into the society, such as those afflicted with a disease and ex-convicts. Private charitable organizations are also a strong force in providing immediate help in cases of catastrophe in and outside Germany. Under certain conditions, one-time or recurring payments are made to individuals in case social welfare payments are not sufficient to maintain human dignity.

All the activities described above are coordinated by five large organizations: the Welfare Organization of the Protestant Church, the Welfare Organization of the Roman Catholic Church, the Welfare Organization of the Jewish Community, the Welfare Organization of the Trade Unions, and the German Red Cross. In addition, there are numerous small private charitable activities, all of which are organized as associations.

The most important sources of funds for these organizations are membership fees, private donations, governmental grants, and investment income. In addition, the organizations of the religious grups mentioned above receive grants from their respective churches, which account for a considerable portion of their total income.

Tax Incentives

Under German income tax regulations membership fees and donations by individuals or corporations are deductible from taxable income if the following conditions are met:

1. The articles of the receiving organization must provide that charitable, religious, scientific, or other activities of public benefit are the organization's sole objective.
2. The actual conduct of activities of the organization must be in agreement with the objectives of the articles.
3. In case of "other activities of public benefit," the benefit to the community through such activities must be explicitly confirmed by the tax office in advance. These organizations are included in a special list which is published in the German income tax regulations. The tax deductibility of membership fees and donations is limited to 10 percent of the individual's or corporation's annual taxable income in case of scientific organizations, and to 5 percent in the case of all other organizations.

Matching Grant Programs

No such programs are provided in Germany.

Financing of Charities

Federal, state, and municipal authorities often subsidize the recurring activities of charitable institutions and grant contributions for capital expenditures of these organizations. Such grants have to be included in the budget of the respective ministry and are subject to parliamentary approval.

Taxation of Charitable Organizations

In principle, all organizations and associations in Germany are subject to the same taxes as business corporations—corporate income tax, property tax, and so forth. If, however, the articles of an organization specify that charitable, religious, scientific, or other activities of public benefit are to be the sole objective of the organization and if that organization is actually run to meet this objective, these organizations are exempt from income taxes on membership fees, donations, governmental grants, and capital income. Income from business activities is, however, subject to income taxes.

Charitable organizations that meet the above requirements are also exempt from property taxes. Further, under German tax laws, taxes are not levied on a bequest as such, but on the enrichment of each heir. Charitable organizations are exempt from this tax.

Nonprofit organizations are not exempt from taxes other than on income, property, and bequests, except as follows: (1) Real estate tax is not levied on real estate owned by these organizations if it is directly used for the organizations' objectives; (2) turnover tax is not levied on services of these organizations which are rendered in accordance with their statutory objectives.

Administrative and Governmental Control

In principle, private charitable organizations are not subject to any governmental administration or supervision. Governmental grants, however, are audited by federal or state audit departments to determine that they have been used for the purpose for which they have been granted. Reports, including financial reports, do not have to be presented to governmental agencies.

Books and financial statements, as well as the articles of association and the actual conduct of activities of charitable organizations, are subject to tax reviews. The purpose of these reviews is to determine that all those conditions have been met that are required in order to make contributions tax deductible for the contributing individuals and businesses and to grant tax exemption to the organization itself.

Special Rules Applicable to Religious Groups

The Official Protestant Church, the Roman Catholic Church, and the Jewish Community are public corporations entitled to levy a church tax on their members, which varies from 8 percent to 10 percent of those members' personal income tax. This tax is administered on behalf of these churches by the German tax authorities. The revenue from this tax is so material that these churches are able to allocate sufficient funds to their own charitable organizations. The churches are exempt from income and property taxes. The church tax is fully deductible from the taxpayer's taxable income.

All other religious groups are organized as private associations. The financing sources of these groups are restricted to voluntary membership fees and donations. Since, under normal circumstances, the articles of these organizations determine religious activities as the sole objective, they are exempt from income and property taxes and their members are authorized to deduct contributions from taxable income up to 5 percent thereof.

Both churches and religious groups are not required to publicly report on their financial situation.

VI

ITALY

Scope of Activities of Private Philanthropic Organizations

The majority of social welfare programs in Italy are conducted by government, and accordingly, the scope of private charitable activities in Italy is relatively limited. Donating to charity is not common or customary practice in Italy.

The main types of charitable organizations operating in Italy are:

1. Organizations rendering public assistance to specific needy groups, for example, assistance to indigent and invalid persons, protection of women and children, social redemption, assistance to orphans, abandoned children, and old people.
2. Religious organizations which also carry out charitable activities.
3. De facto foundations whose objectives are normally very specific and have well-defined time and scope limits, for example, assistance to victims of a flood or earthquake.
4. Private foundations for assistance to particular categories of disabled persons (blind, deaf, spastics). These foundations often originate from bequests.
5. Foundations that realize their objectives by directly operating institutes for children, old persons, orphans, and so forth.
6. School assistance foundations having as a main objective the assistance of students.
7. Military foundations, assisting orphans of soldiers, old soldiers, and so forth.

Tax Incentives

Tax incentives for individuals and businesses who contribute to charities are as follows: (1) No income tax incentive is provided for individuals contributing to charities; (2) Enterprises contributing to charities are allowed to deduct from their taxable income amounts of such contributions up to a maximum of 2 percent of declared taxable income; (3) Gifts and bequests in favor of recognized associations and foundations having charitable or other public assistance purposes are exempt from gift and succession taxes. Gifts and bequests of real estate are also exempt from the tax on increase in value of land and buildings (INVIM).

Matching Grant Programs

The Italian government has no matching grant program for private charitable contributions.

4.3

Financing of Charities

The law relating to the annual State Budget has specific provisions relating to the amounts to be granted by the various ministries to public and private charitable organizations operating on a national scale. The funds appropriated for such uses are granted subject to control by the ministerial authorities. The Ministry of Interior administers charitable activities through the Department of Public Assistance.

Other financing of charities is provided in the form of special governmental or regional contributions on the request of the charitable organizations for expenses incurred of an exceptional nature.

Taxation of Charitable Organizations

Charitable organizations are exempt from income taxes on contributions; however, revenue-producing activities are subject to income taxes computed at one half of the State income tax rate, plus local tax. Income from the ownership of real estate is subject to income taxes. Contributions of personal property to charitable associations and foundations are exempt from the value added tax. As noted above, gifts and bequests in favor of charitable associations and foundations are exempt from gift and succession taxes. If such gifts and bequests relate to real estate, they are also exempt from the related tax on increased value.

Administrative and Governmental Control

The activities of private charities are regulated by several laws, some of which were enacted years ago.

Private charitable activities are regulated by the Italian Civil Code which provides for two forms of organization: (1) associations—groups of individuals who associate themselves for the purpose of giving assistance and performing charitable activities; (2) foundations—endowments of assets destined for assistance and charitable purposes.

A private legal entity status (*ente morale*) for associations and foundations is acquired through recognition by a decree of the President of the Republic. A private or public charity cannot be a corporation, since that form of organization can only be used for commercial or industrial activities.

Charitable organizations which are legal entities are subject to control by the Ministry of Interior. Among these controls is a requirement that purchases of real estate and receipts of donations are subject to government reviews.

Such control is delegated to regional and provincial authorities to which charitable organizations must present their annual financial statements. The controlling authorities seldom audit such statements. Private, nonprofit entities are required to file tax returns with financial statements attached thereto.

Special Rules Applicable to Religious Groups

There are no special tax rules for religious organizations. They are treated as any other private charitable organization. Thus, religious organizations are subject to income taxes if they operate hospitals, schools, or perform other revenue-producing activities (taxed at one half of the State income rate, plus local tax). However, buildings that are devoted solely to worship are not considered to be income-producing properties and therefore are exempt from any related income tax.

VII

JAPAN

Scope of Activities of Private Philanthropic Organizations

The social welfare program in Japan is somewhat limited. Approximately 60 percent of the program is controlled and/or subsidized by national or local government agencies, with the remainder carried on by private charitable organizations. Social welfare corporations which are limited by statute to solely charitable activities account for about one half of the private charitable sector, with nonprofit corporations (which may also engage in profitable activities) and individuals accounting for the rest. Approximately 65 percent of the activities conducted by private charitable organizations are concerned with the care of working mothers' children. Other activities include providing homes and services for the aged, handicapped, and orphaned.

Tax Incentives

The government allows tax deductions to individuals and corporations for certain charitable contributions. Contributions by individuals to the Community Chest Society and to social welfare corporations are deductible up to 25 percent of gross income less the lower of 3 percent of gross income or ¥ 100,000 ($333).

Corporations are allowed unlimited deductions for contributions to the Community Chest Society. Deductions for contributions to social welfare corporations are limited to 1.25 percent of taxable income for the current accounting period plus .125 percent of the paid-in capital at balance sheet date.

Bequests in Japan are generally taxed to the recipient rather than the donor. Certain private charitable organizations are exempted from such tax on bequests they receive.

Matching Grant Programs

The government does not have a matching grant program.

Financing of Charities

Government financing of charities other than through tax incentives is as follows: (1) National and local governments give subsidies to social welfare corporations; (2) The Social Welfare Improvement Society makes loans available, under certain conditions, to social welfare corporations and certain nonprofit and religious corporations.

Taxation of Charitable Organizations

Income tax. Income from nonprofit activities of social welfare corporations and nonprofit corporations are exempted from income tax. Income of the Social Welfare Improvement Society is also exempt from income tax. A national corporate income tax rate of 23 percent is applied to income from profit-oriented activities of social welfare corporations and nonprofit corporations. The normal corporate tax rate is 40 percent.

Property tax. Properties used for charitable activities and owned by social welfare corporations, nonprofit corporations and the Social Welfare Improvement Society are exempt from property tax.

Inheritance and gift tax. Properties acquired through inheritance or bequest and gift by social welfare corporations, nonprofit corporations and individuals whose activities improve charities are not subject to inheritance and gift tax.

Other taxes. Social welfare corporations are not subject to the revenue stamp, registration, real property acquisition, and admission taxes.

Administrative and Governmental Control

The Ministry of Public Welfare is the federal agency to which local governments report. Local governments supervise charitable activities, as follows:

Social welfare corporations. The designated accounting period for social welfare corporations is the fiscal year ended March 31. Prior to June 30, the following reports must be submitted to the Minister of Public Welfare through the local government: summary of operations, list of properties, statement of receipts and expenditures for the current year, estimated statement of receipts and expenditures for the coming year, summary of collateral held for loans.

An internal audit is performed by an inspector elected by the corporation. An audit performed by local government is reported to the Ministry of Public Welfare. This yearly audit covers operations and accounting.

The initial establishment of the corporation must be approved by the local government. Registration with the National Registration Office at the time of establishment of the charity is required.

Public welfare corporations. The establishment of the corporation must be approved by the Minister of Public Welfare. Registration with the National Registration Office at the time of establishment is required. Public welfare corporations may also be required to submit to the Minister of Public Welfare, within three months of the end of the fiscal year, a listing of properties owned and members.

Special Rules Applicable to Religious Groups

Religious corporations engaged in public interest activities are treated in a similar manner for tax purposes as other charitable entities.

As noted above, a religious corporation engaged in charitable activities may borrow funds from the Social Welfare Improvement Society. Generally, religious corporations are not required to submit financial statements to any governing body.

VIII

SWEDEN

Scope of Activities of Private Philanthropic Organizations

Private charitable activities in Sweden are very limited because of the highly developed social security program of the government, which in principle guarantees everyone acceptable living conditions. The view that the government "takes care of" everyone is one of the basic theses of the Swedish Social Democratic Government. The climate for private charity is consequently not very good and the incentives are few.

However, several "charitable organizations" do exist and supplement with their activities the government in areas where it has failed or where additional help is considered necessary, for example, criminals, alcoholics, drug addicts, international aid to underdeveloped countries, and areas of catastrophies.

Tax Incentives

The legislators have shown a rather restrictive attitude when granting tax incentives to contributors to charitable organizations for the reasons explained above. The general rule is that donations or contributions to charitable organizations are not tax deductible. Consequently, charitable organizations do not pay any income tax on such contributions from individuals or businesses. Neither do they pay tax on charitable bequests. Income from property or a business owned by a charitable organization is taxed at reduced rates.

It is also possible to direct charitable bequests to a special foundation existing or formed by the donor with a recognized purpose. Such charitable bequests are tax free.

If the donor is an individual person or a company and the donee is an individual person, the donor can get an expense deduction within certain limitations in arriving at taxable income, if the payment is classified as a periodic charity. The payments must then be given to the same donee regularly and at short intervals. The donee is required to pay income tax on the same amount.

Matching Grant Programs

The government does not have a matching grant program for matching private contributions to charitable organizations.

Financing of Charities

Charitable organizations may obtain subsidies from the government to cover costs that they have incurred in connection with charitable activities. They can also receive grants and contributions from the government to cover charitable activities. Such subsidies and grants are not taxable to the organization.

Taxation of Charitable Organizations

Charitable organizations pay local income tax on real estate and business income. Business income is also subject to national taxes. Certain types of income, such as membership fees and subsidies from the government, are exempt from all income taxes.

Taxes on income of charitable organizations are computed at lower rates than taxes on income of corporations. The charitable organizations are subject to added value tax but are not subject to property tax.

Administrative and Governmental Control

Charitable organizations are required to file tax returns applicable to income from real estate and business. In order to obtain grants, subsidies, and contributions, charitable organizations must submit financial statements to the government.

Special Rules Applicable to Religious Groups

Religious groups are subject to the same tax rules as other charitable organizations. They pay local tax on income from real estate and national and local tax on business income, based on the same determinations as for other charitable organizations. Religious groups finance most of their activities from membership fees, which are not taxable. The Swedish Lutheran Church (the national church) is financed through a special tax paid by all taxpayers.

TAXATION AND PHILANTHROPY IN CANADA

R.M. Bird[†] and M.W. Bucovetsky[†]

Introduction

The tax scene in Canada over the last few years has been a tumultous one: Royal Commissions have come and gone, official White Papers on taxation have been launched and sunk, hearings have been held, countless articles written, and, not so finally, a good deal of new tax legislation has in fact been enacted. While in many respects the outcome of all this activity has been much less fundamental change than was initially expected,[1] there have nevertheless been a number of significant revisions in the structure of both federal and provincial taxes. The present paper focuses on the implications of several of these recent developments for private philanthropy.

One point which must be borne in mind, particularly by American readers, in assessing this recent Canadian experience is that there is little evidence that concern with the effects of taxation on private philanthropy has weighed very heavily on anyone's mind during the past decade of intensive concern with tax reform. That few appear to be concerned with such effects, however, does not mean that they are nonexistent. On the contrary, it seems highly probable that several of the recent tax changes have affected charitable giving and bequests to a significant degree. Three changes stand out in this respect: the increase in the limit for charitable contributions as a deduction from income, the introduction of a capital gains tax with deemed (or constructive) realization at death or gift, and the closely related phenomenon of the abolition of the federal estate tax and the consequent peregrinations of the various provincial succession duties. The bulk of the present paper is therefore concerned with describing and evaluating these measures.

It is important to emphasize from the beginning that deemed realization cannot be considered without simultaneously considering the recent startling changes in Canadian death taxes. In turn, this point brings out the much greater significance of the provinces in Canada than of the states in the United States: only in terms of the dominance of the federal-provincial issue in all Canadian public finance can one hope to grasp exactly what has happened in Canada and why.

Chapter I of this paper sketches briefly the dimensions of private charity in Canada. Relative to the public sector, philanthropy is much less important in Canada than in the United States. One reason why there has not been much concern with the effects of taxation on private philanthropy in Canada may thus simply be because private philanthropy is, on the whole correctly, not considered to be very important. Against this general background, Chapter II summarizes the course of tax reform in Canada since the mid-1960s with respect to those tax changes that can be explicitly related to charitable giving. This review of the facts includes a brief look at the attitudes towards philanthropy—and to some extent towards private wealth—revealed in the course of tax reform. Chapter III then discusses in some detail the debate on the federal capital gains tax, particularly the deemed realization provisions, and its close connection with the death tax field. Some aspects of the implementation of deemed realization are then sketched in Chapter IV. The final chapter appraises briefly the probable effects of these measures on private philanthropy. In view of the very short time that most of the relevant legislation has been on the books, this appraisal is largely qualitative rather than quantitative. A few reflections on possible implications of the Canadian experience for the United States conclude the paper.

[†] Institute for Policy Analysis, University of Toronto.

I

THE DIMENSIONS OF PRIVATE PHILANTHROPY IN CANADA

One of the most striking differences between Canada and the United States is the relatively larger role that the government sector has long played in Canada.[2] In 1972, for example, total government expenditure in the United States came to 32.2 percent of G.N.P. compared with 38.5 percent in Canada (see Table 1). A significant part of this difference is attributable to the greater importance of transfer payments to persons and of government expenditures on hospitals in Canada. As shown below, this larger public sector is mirrored by the much smaller role of private philanthropy in Canada. This relationship is not accidental; rather, it reflects a fundamentally different division in the two countries between the public and private shares in those activities that may be broadly considered to have "philanthropic" attributes. The voluntaristic tradition in Canada has always been less significant than in the United States, and the tendency to turn to government correspondingly greater. As one perceptive American observer has noted: "Canada, with its greater stress on elitism and particularism than the United States, would be somewhat more collectivity-oriented than this country."[3] The course of recent political events, and the statistics, both lend support to this observation.

Table 1

The United States and Canada: Selected Comparisons, 1972

	United States	Canada
Total government expenditure as percent of G.N.P.	32.2	38.5
Government transfer payments to persons as percent of G.N.P.	8.5	9.5
Total personal expenditure on goods and services		
As percent of G.N.P.	62.9	58.3
Per capita	$3,479	$2,761
Personal expenditures on "Medical Care"		
As percent of G.N.P.	5.0	1.7
As percent of total personal spending	7.9	2.8
Per capita	$ 275	$ 79
Government purchases of goods and services for "hospitals"[a]		
As percent of G.N.P.	1.4	2.8
As percent of total government expenditure	4.5	7.2

a. The U.S. figure refers to all purchases for "health and hospitals" and is thus more inclusive than the Canadian figure, which is for hospitals alone.

Sources: Canada – Statistics Canada, Revised National Income and Expenditure Accounts (computer printout).

U.S. – U.S. Department of Commerce, *Survey of Current Business*, Vol. 53 (July 1973).

Although the proportion of total government expenditure (including transfer payments) accounted for by health, social welfare, education, recreation, and housing—assuming these categories to embrace the relevant activities—is about the same in Canada as in the United States, the larger size of the government sector as a whole ensures that the public share in these activities is substantially more significant in Canada.[4] The comparison is particularly striking with regard to family allowances, health and welfare expenditures, and, to a lesser extent, education. Since 1945, for example, the Canadian federal government has paid a monthly allowance to the mother of every resident child: at present this grant averages $20.00 per month, subject to cost-of-living escalation, for every child under 18. In addition, comprehensive government-administered insurance covers most hospital and medical care in Canada. The result is that while total per capita expenditure on health in 1971 was $306,[5] private medical expenditure came to only $73, compared with $251 in the United States in the same year.

So far as education is concerned, in 1970-71 only 2 percent of elementary and secondary school pupils in Canada were enrolled in private schools.[6] This low proportion in a country with such a high proportion of children in religious schools is, of course, due to the fact that the "public" schools, which are paid for out of tax revenues, include most of the numerous Roman Catholic separate schools.[7] Even at the university level, less than 10 percent of total spending in the most recent year for which data are available came from private sources (other than fees).

In short, there is a much stronger emphasis on public sector spending in the traditional philanthropic fields in Canada than in the United States. Another statistic reflecting this difference is that personal expenditure on goods and services amounted to only 58 percent of G.N.P. in Canada in 1972, compared with 63 percent in the United States in the same year (Table 1). Canadians thus have less income at their disposal to spend on charity or anything else. They also, as we have seen, have less need to depend on private sources for financing many of the activities in which private philanthropy traditionally plays a significant role. Whichever way the causality runs, however, it remains that the relatively larger tax burden and size of the government sector on the one hand is matched by a lower level of private giving and philanthropic activity on the other.

Although the lesser importance of private philanthropy in Canada appears to be neatly matched by the lesser availability of information on the subject, the available data suggest that annual private giving in the United States is likely to be close to three times that in Canada, whether measured in terms of shares of G.N.P. or per capita. The remainder of this section provides the evidence leading to this conclusion.

Individual Donations

Four separate estimates have been made, covering respectively annual giving by individuals, annual corporate giving, bequests, and foundations. Table 2 contains the basic data available with respect to individual charitable contributions in Canada. As shown in that table, the amount of itemized charitable deductions claimed for income tax purposes in 1971 (the year for which a global estimate has been made) was $281 million, or an average of $319 per return making a specific claim for the charitable deduction. Only 9.2 percent of those filing income tax returns claimed this deduction in 1971, down from 12.2 percent in 1968. Donations made by those claiming the standard deduction are not, of course, reflected in these figures. In 1956, for example, the year before the standard deduction came into effect, the total donations claimed for $284 million, or more than the itemized donations in any year from 1966 to 1971.[8]

The magnitude of the adjustment required is suggested by some information available for 1967, when a sample study of expenditures by urban families found that charitable contributions averaged $73.20 per family, or 1.1 percent of expenditure.[9] If one makes the heroic assumption that this ratio can be extended to total personal expenditure as shown in the national accounts, the implied estimate of personal charitable contributions in 1967 is $454 million, or about 87 percent more than that shown in Table 2 as itemized for income tax purposes in that year.

Table 2

Individual Charitable Contributions, Canada, 1961-1972

Taxation Year	Total Number of Returns (Taxable and Non-Taxable)	Number of Returns with Specific Medical Claims	Number of Returns with Specific Charitable Donation Claims	Amount of Standard Deductions Claimed (in millions of dollars)	Amount of Specified Charitable Donations Claimed (in millions of dollars)
1961	5,961,383	N.A.	N.A.	$459.0	$312.2
1962	6,137,227	N.A.	N.A.	496.9	297.3
1963	6,330,943	N.A.	N.A.	484.1	317.3
1964	6,719,512	N.A.	N.A.	507.4	333.8
1965	7,162,169	N.A.	N.A.	562.1	305.0
1966	7,732,123	N.A.	N.A.	650.4	223.7
1967	8,133,095	N.A.	N.A.	686.4	242.8
1968	8,195,184	828,710	1,036,799	716.5	251.1
1969	8,862,066	668,940	966,959	763.4	259.8
1970	9,183,407	496,249	919,135	805.6	268.5
1971	9,533,292	364,366	879,635	861.1	280.8
1972	10,382,095	259,354	938,211	933.3	345.4

Source: Department of National Revenue, ***Taxation Statistics***, annual.

It is not possible, however, to blow up the figures for other years by the same proportion because of the interrelation between the charitable and medical deductions and the standard deduction. Table 2 indicates clearly that the rapid spread of government-provided health care in the late 1960s resulted in an equally rapid decline in the number of returns with itemized medical claims. It follows that the amount of charitable donations which is not separately itemized has probably been increasing in recent years, that is, more taxpayers are finding that the combined total of allowable medical and charitable deductions—and, in sharp contrast to the United States, these are the only personal expense deductions allowed in Canada—is less than the standard deduction, the amount of which ($100) was not changed over this period.[10] This phenomenon would also explain the otherwise puzzling decline in both the number of returns claiming the itemized charitable deduction and the amount of deductions so claimed.

A simple way of getting around this problem is to note that if the 1967 estimate for total personal contributions based on the above-mentioned survey is accepted, then the average charitable contribution made by each taxpayer claiming the standard deduction in that year would have been just under $31 (assuming no contributions were made by non-taxfilers). If this *level* of contribution is assumed to have been maintained in subsequent years, given the number of returns claiming the standard deduction, total individual donations in 1971 may be estimated at $543.0 million. In per capita terms, this amounts to $25, a figure which can be compared to estimated per capita individual giving in the Untied States in 1971 of about $74.[11]

The assumption that the absolute amount of giving remained constant from 1967 to 1971 may be thought to lead to an understatement, just as the assumption that rural families give as much as urban families may perhaps lead to some overstatement. On the other hand, the assumption of constancy is supported by the results of the only expenditure surveys reporting roughly comparable data on giving, which showed, for example, that average contributions to charitable organizations by urban families of two or more persons were $76 in 1959, $81 in 1964, and $79 in 1967, with about the same proportion of families reporting such contributions in each year. For all families, the figures were $75 in 1964 and $73 in 1967; this figure is not available for 1959.

The surprising constancy of these figures over time may perhaps suggest that for many people charitable donations are really in the nature of "social dues." That is, there is a socially acceptable minimum contribution level which is defined largely in absolute nominal terms rather than as a proportion of income or in "real" terms. The fact that most donations by most people go to either religious organizations or "general welfare" appeals such as the United fund or the heart fund strengthens this argument: The family that puts $1 in the weekly church collection or gives $5 to the annual appeal for this or that is unlikely to adjust its contribution level to take account of either gradual changes in its income level or the value of money. Although irregular jumps from time to time can be expected—who puts a quarter in the collection plate these days?—it therefore seems quite reasonable to expect that the low level of contributions which make up the bulk of individual giving will remain fixed in absolute terms over periods of a few years. (Incidentally, it should perhaps be noted that this argument in no way depends on "money illusion": what the donor is buying is not less of a real good or service but the same amount of self-respect, social prestige, or however else one wishes to characterize it. Only when the purchase price of this "good" goes up for him will he pay more for it—unless, indeed, he truly does suffer from "money illusion". At any rate, this assumption has been made for purposes of the present estimates.)

Corporate Donations

Corporate charitable donations give rise to fewer problems. Both claims for tax purposes and donations recorded in company books are available for recent years: as shown in Table 3, the two series are not very far apart. Although the ratio of these donations to corporate book profit (before direct taxes and non-recurring items) is not very high—being only 0.74 percent in 1969 and 0.81 percent in 1970—it is not much lower than the similar ratio in the United States (1.08 percent in 1970).[12] Corporate charity in the United States was thus only modestly higher than in Canada, in sharp contrast to the much higher level of individual giving in the former country.

Table 3

Corporate Charitable Donations, Canada, 1956-1970
(in millions of dollars)

Fiscal Year	Charitable Donations Reported for Tax Purposes	Charitable Donations Recorded on Company Books
1956	$32.0	$N.A.
1957	34.9	N.A.
1958	35.3	N.A.
1959	42.4	N.A.
1960	38.6	N.A.
1961	38.1	N.A.
1962	39.9	N.A.
1963	41.7	N.A.
1964	46.2	N.A.
1965	N.A.	66.7
1966	N.A.	64.3
1967	N.A.	74.4
1968	69.4	72.2
1969	62.7	66.5
1970	59.7	68.5

Source: Data prior to 1965 from Department of National Revenue: *Taxation Statistics Part 2*, annual; Data for 1965 and later years from Statistics Canada: *Corporation Financial Statistics*, annual.

Charitable Bequests

Curiously, there are no published figures on the amount of charitable bequests in Canada. It appears, however, that the "exempt property" category tabulated in the annual federal estate tax statistics (until 1971) is approximately coterminous with bequests to charitable institutions. These figures are therefore used in Table 4 as the basis for an estimate of the amount of charitable bequests. This estimate is unquestionably understated, however, both because these figures do not include estates under $50,000 and because they do not include bequests to nonexempt organizations which can be considered philanthropic in character. The federal data have therefore been adjusted on the basis of data available for one province (Ontario) in one year (1963-64).[13] Crude as this adjustment inevitably is, it is not as bad as one might think both because Ontario residents constitute such a large fraction of the wealthy who die in Canada—in 1971, for example, Ontario estates paid 45 percent of the total federal estate tax—and because the relative composition of the total estate base in terms of both size and donations to nonexempt philanthropies is unlikely to change very rapidly over a period of a few years. In any event, no other procedure is available on the basis of existing data.

Table 6

Estimates of Charitable Bequests, Canada, 1960-1971
(in millions of dollars)

Fiscal Year	Amount of Property "Exempt from Federal Estate Tax"	Estimate of Total Charitable Bequests
1960	$11.9	$ 17.4
1961	34.2	50.0
1962	14.7	21.5
1963	22.5	32.9
1964	27.4	40.1
1965	29.9	43.8
1966	103.7	151.9
1967	37.9	55.4
1968	43.5	63.7
1969	73.5	107.6
1970	41.4	60.6
1971	50.5	73.9

Sources:
Column 1: Department of National Revenue, *Taxation Statistics*, annual. Entry under "less exempt property" of Assessed Estates.

Column 2: Column 1, blown up on the basis of data for 1963-64 from K. Cheng, J.A.G. Grant and H.M. Ploeger, *Ontario Estates in 1963-64*. A study prepared for the Ontario Committee on Taxation (Toronto: Queen's Printer, 1966). (See note 13 in text on the precise nature of the adjustment made.)

Despite the age and restricted scope of the Ontario study cited above, there is no other comparable source available in Canada: Tables 5 and 6 have therefore been included here in part to illustrate that while the *level* of charitable bequests may be different in Canada than in the United States, the *pattern* is very similar. The dominance of educational and religious purposes in charitable bequests (41 and 28 percent, respectively), for example, is clear from Table 6. Also as in the United States, the larger estates gave relatively more to education and relatively much less to religion than the smaller (under $100,000) estates.[14] Becuase the very largest estates left much more to charity than the smaller estates (see Table 5), educational institutions were the largest single recipients of bequests in 1963-64. In view of the rapid expansion of government funding of higher education during the subsequent decade, it is not clear whether this pattern still exists today.

Foundations

The most speculative of all the spectulative estimates in this section concerns the foundation sector, which is clearly a particularly under-developed region in Canada. Although a beginning has recently been made in this area, with the issuance of a foundation directory and the establishment of a new periodical concerned with foundations,[15] data on foundation activities are still very hard to come by. The situation is indicated by the recent report

Table 5

Summary by Size Class of All Ontario-Domiciled Estates Assessed for Provincial Succession Duties in Fiscal Year 1963-64

Size of Estate	Number of Estates	Total Net Value (in thousands of dollars)	Provincial Succession Duties Paid (in thousands of dollars)	Percent of Net Value of Estate Bequeathed to Charity		Percent of Estates Making Exempt Donations
				Duty-Exempt Donations	Nonexempt Donations	
Under $25,000	1,173	$ 18,312.3	$ 1,225.9	1.8%	0.4%	19.6%
$25,000-49,999	754	26,565.7	2,416.1	3.4	0.6	26.2
$50,000-99,999	1,189	84,287.3	5,380.2	1.6	0.2	16.6
$100,000-199,999	354	74,817.8	6,888.9	3.5	0.1	22.0
$200,000-499,999	235	70,316.6	8,418.1	5.0	0.3	33.2
$500,000-999,999	51	35,715.6	5,364.7	2.9	0.9	54.9
$1 to $7 million	27	55,292.1	9,985.3	16.7	0.1	59.2
Total	3,783	$365,307.4	$39,679.2	5.2	0.2	21.8

Source: K. Cheng, J.A.G. Grant and H.M. Ploeger, *Ontario Estates in 1963-64*, A study prepared for the Ontario Committee on Taxation (Toronto: Queen's Printer, 1968).

Table 6

Duty-Exempt Charitable Bequests by Beneficiary Class (All Ontario Estates Assessed for Provincial Succession Duties in Fiscal Year 1963-64)

Category of Recipient	Amount of Duty-Exempt Donations (in thousands of dollars)	Percent of Total Duty-Exempt Donations	Percent of Total Net Value of Estates
Universities	$ 2,149.4	11.3%	0.6%
Other educational institutions	5,677.7	29.9	1.6
Religious purposes within Ontario	5,019.7	26.4	1.4
Religious purposes in Canada, outside Ontario	228.9	1.2	0.1
Religious purposes outside Canada	55.5	0.3	0.0
Hospitals, general medical	1,014.0	5.3	0.3
Government and government hospitals	138.2	0.7	0.0
Other medical	1,800.7	9.5	0.5
Other donations	2,893.1	15.2	0.8
Total	$18,977.2	100.0	5.2

Source: See Table 5.

that only three of the ten provinces (which are responsible for supervision of foundations) could even identify with any degree of certainty the foundations located within their boundaries.[16] Canadian foundations seem extremely reluctant to divulge information on their finances and activities. The only financial information which could be located consists of isolated references such as the fact that the "largest" of Canada's estimated 1,400 foundations hold over $700 million in assets[17] or (same author) that the largest 15 foundations account for $400 million in assets.[18] The largest single private foundation in Canada, the J.W. McConnell Foundation, distributed $5.1 million in 1969. There are also a few community foundations, with $43 million in assets and grants of $3 million in 1971.[19] Unlike the pattern in the United States, corporate foundations are small in number and even smaller in importance, according to the scanty available information. In total, it would appear that a very generous estimate would be that all foundations in Canada have total assets of about $1 billion, with annual grants on the order of $75 million or so.[20]

The results of these four separate estimates may now be put together for the 1971 calendar year (which requires a few further adjustments), as follows:

Individual donations	$543 million
Corporate donations (excluding corporate foundations)	71 million
Bequests	64 million
Foundations	75 million
Total charitable giving	$753 million

For whatever it is worth, the only similar estimate which has been located is roughly comparable in magnitude, although there is no information on how it was derived.[21] Annual charitable giving in Canada, according to these figures, thus amounts to about 8/10ths of one percent of G.N.P. or $35 per capita. These figures may be compared with the 1971 U.S. figures of about 2 percent of G.N.P. and $103 per capita.[22] No matter how rough the estimates in this section, it is thus clear that the level of private philanthropic activity in Canada is well below that in the United States. As noted before with respect to charitable bequests, however, the *pattern* is very similar, with individual donations accounting for 72 percent of the total (71 percent in the U.S.), corporate donations 9 percent (4 percent), bequests 8 percent (14 percent) and foundations 10 percent (14 percent). The major difference from the U.S. pattern is that bequests are relatively less important and corporate donations—though, as seen above, less as a proportion of profits than in the U.S.—are relatively larger.

II

TAX MEASURES EXPLICITLY RELATED TO PHILANTHROPY

In the mid-1960s the main characteristics of the Canadian tax system so far as its effects on philanthropy are concerned consisted of a limited income tax deduction for charitable donations, no tax at all on capital gains,[23] and significant death taxation at both the federal and provincial levels, with more or less general exemptions for charitable bequests. Ten years later, the income tax deduction was larger, the death taxes were much smaller, and capital gains were taxed not only on realization but also on death or gift. The central concern of this paper is the evolution of these measures over this period, with special attention to the attitudes towards private philanthropy (and the role of public policy towards private philanthropy) revealed in the course of the extensive debate on tax reform which has taken place in Canada. The present section deals with those tax changes that can be related specifically to charitable giving; Chapter III then deals more broadly with the capital gains tax and death taxes. While much of the discussion may appear to bear down rather heavily on minor details, it is, after all, in the details that basic issues find their resolution. Moreover, since the basic issues have not really been discussed in Canada, one must in any case infer the prevalent attitudes toward them from an examination of the details.

The Charitable Deduction

The deduction for charitable contributions first appeared in the Canadian income tax in 1930. It has changed little since. As was the case when a similar deduction was introduced in the United States in 1917, the parliamentary discussion of this measure made little explicit reference to its rationale or purpose. Indeed, one reason for this lack of discussion was apparently because the previous U.S. example was taken to prove the case.[24] The Prime Minister, Mr. Bennett, made it clear, however, that the intent of the deduction was to encourage wealthy taxpayers to contribute to "useful, philanthropic and religious purposes."[25] As in the United States, the purpose of the exemption for charitable donations was thus ". . . to promote munificence or at least to protect charities against the indirect consequence of high rates of income tax on those who sustain them."[26]

Despite the apparent intention to favour the wealthy most, from the beginning the size of the charitable deduction which could be claimed was limited, for many years to 10 percent of income. Although no clear reason was given for introducing such a ceiling, it seems highly probable that this limitation was motivated by the desire to reduce the possibility of abuse of the deduction for purposes of tax avoidance. Unlike the case in the United States, the same ceiling has also been applied from the beginning to individual and corporate taxpayers alike. As noted in the previous chapter, corporate donations have customarily been far below this ceiling—less than 1 percent in 1970, for example. Table 7 shows clearly that individual taxpayers too have, as a group, been in little danger of exceeding this limit.[27]

A particularly interesting feature of Table 7 is that taxpayers with the lowest incomes appear to be the group most likely to approach any ceiling.[28] This result may well reflect the strong "social dues" aspect of many charitable donations which was noted earlier in connection with the estimates of individual giving. If it is correct that the socially acceptable minimum contribution level is defined to a large extent in absolute rather than relative terms, it will form a relatively larger proportion of the income of lower than of higher income groups. This is exactly what one sees in Table 7, with the important exception of the upward turn of the ratio for the highest income group (though even then it remains well below that for those under $10,000). In these rather aggregative data, it thus appears that the "price effect" of higher tax rates is not very strong, especially if one recalls that marginal rates are much higher in the middle income ranges in Canada than in the United States (for example, the rate is 55 percent on taxable income of $24,000).[29] Very similar results emerge in the survey data referred to earlier, that is, as incomes rise, a larger proportion of people give, but they give less in relation to income. Neither this argument nor the statistics in Table 7, however, should be taken to deny the possibility that some individual contributors, particularly at the higher income levels, may indeed have approached and even exceeded the ceiling.

This possibility has in any case clearly been often in the mind of policy makers, as is evidenced by the way in which the limit of deductibility has in fact been extended over time. First, the income base with reference to which the limit is calculated was altered from the original "net taxable income" to just "income," which presumably meant assessed income.[30] Second, a one-year carryforward for contributions which exceeded the limit in any one year was introduced in 1957. Third, unlimited contributions to certain institutions—at first just federal government museums and certain other federal institutions, but after 1968 also similar provincial institutions—were permitted. In view of the extensive role of the public sector in the cultural field in Canada, the potential scope of this extension would appear to be quite wide, although it appears not to have yet been tested much in practice.

The Royal Commission on Taxation (Carter Commission) which reported in 1967 did not recommend any substantial change in this system, nor did it discuss the rationale of the deduction except to note that charitable giving was "a socially desirable objective."[31] The possibility of substituting a credit approach for the deduction, while said to be more equitable, was dismissed without discussion as tending ". . . to stifle charitable giving by upper income individuals and families."[32] A floor of, say, 1 percent on charitable contributions, with only the excess being deductible was also rejected on the reasoning (?) that ". . . a limit of this nature might tend to restrain charitable giving by upper income taxpayers that the allowance is designed to encourage."[33]

Table 7

Charitable Donations Itemized on Income Tax Returns, 1972

Income Class	Number of Returns	Charitable Donations (in thousands of dollars)	Estimated Assessed Income[a] (in thousands of dollars)	Donations as Percent of Estimated Income	Average Donation per Return	Proportion of Returns with Itemized Donations
$0-5,000	211,745	$ 42,365	$ 542,491	7.8%	$ 200	4.3%
$5,000-10,000	333,161	100,234	2,421,747	4.1	301	9.5
$10,000-20,000	284,307	106,196	3,663,296	2.9	374	17.6
$20,000-50,000	92,111	60,025	2,533,697	2.4	652	46.0
$50,000-100,000	14,137	21,705	923,302	2.4	1,535	66.6
$100,000 and over	2,750	14,843	416,672	3.6	5,397	78.0
Total	938,211	$345,368	$10,501,205	3.3	368	9.0

a. The average assessed income on all returns itemizing charitable donations is assumed to be the same as the average for all returns in the same income class.

Source: Revenue Canada, Taxation. *Taxation Statistics*, 1974 Edition (Ottawa, 1974).

In the end, all the commission recommended was that the existing 10 percent limit be raised to 15 percent, for individuals only.[34] No reason was given for introducing this first differentiation between individuals and corporations in Canadian law, though one may perhaps surmise that the authors of the report may have had the U.S. precedent in mind, or that, in line with their view of the corporation as simply a conduit for income, they simply saw no real rationale for any corporate contributions other than as business expenses. All in all, as was noted at the time,[35] the Royal Commission's discussion of the charitable deduction left much to be desired and fell well below the standard of analysis set in the report as a whole. Unfortunately, the scattered, later discussion of this provision seldom rose even to this height.

The major documents in the tax reform debate which appeared between the *Report* of the Royal Commission and the 1971 Tax Reform Act—the government's White Paper in 1969 and the reports of the Senate and Commons Committees in 1970—made no mention of the limit on the charitable deduction at all. Instead, these documents confined themselves to adding certain kinds of organizations (amateur athletic associations, civic improvement clubs) to the list of eligible organizations (see below) and also to suggesting that donations to privately owned museums open to the public be exempted from the limit, as was already the case for similar publicly owned facilities.[36] Not too surprisingly, the only one of these suggestions that carried through to the act was the federal government's own White Paper proposal to include national amateur athletic associations as eligible organizations. In addition, however, the Royal Commission's proposal to extend the limit generally was taken up and made more generous, with the new limit being set at 20 percent. The commission's suggestion to leave the limit at 10 percent for corporations was ignored, however, again without any reason being given, so the expanded limit applies to all taxpayers whether corporate or individual.

Despite the failure of the Senate and House reports to mention the question of the limit, several witnesses who appeared before these committees did so. Two witnesses noted, for example, that in effect the standard deduction discriminated against those low-income taxpayers who actually did make contributions, because everyone got the benefit of the deduction whether he contributed or not.[37] (No one went on to draw the logical conclusion, however, that the introduction of a floor on charitable contributions eligible for deduction would provide a suitable occasion for the elimination of the trivial standard deduction existing in Canada or its explicit incorporation into the personal exemption.) One of the same witnesses also expressed some doubts about the possibility of increasing the limit because, he said, it might act as an "inducement to abuse."[38] It is perhaps worth noting that this witness was one of the very few (which means three or four out of several hundred) heard by the committees who did not represent a special interest business group. A more common sentiment would appear to be that noted above with respect to the museums, that is, the desire to *raise* the limit, even above the 20 percent. This point was brought out strongly in the later debate in the House of Commons on the tax reform bill by one of the very few members to mention the implications of the tax reform for charity, Mr. R.N. Thompson, who made a special point of comparing the new 20 percent limit unfavourably to the recently increased (larger) U.S. limits.[39] Once again, the inveterate Canadian habit of looking abroad, and especially to the south, for guidance appears to have been at work, for Mr. Thompson provided no other basis for his comment.

Turning to a more important point, as discussed in the next chapter, one of the most important innovations in the new act was the provision for taxing most capital gains at death (other than on assets transferred to spouses or spouse trusts). This provision immediately gave rise to an obvious difficulty with regard to charitable bequests. Capital gains on property bequeathed to charity would be brought into income in the year of death, but it was not at all clear whether the value of such bequests would be deductible from the same year's income nor, if they were, whether the 20 percent limit would apply. The new Minister of Finance, Mr. Turner, therefore had to rectify the law in this respect in his first budget in 1972, by making it clear that the value of charitable bequests was indeed to be deducted from the taxpayer's income in the year of death, subject to the normal limit.[40]

The government thus rejected the representations which had reportedly been made to it in favour of permitting deduction without limit of such bequests on the grounds that it was not in fact uncommon for a testator to leave much more than 20 percent of his estate to charities.[41] The government's decision may perhaps have been influenced by the scanty available evidence—see, for example, Table 5—which suggested that even the wealthiest of decedents seldom left as much as 20 percent of their estates beyond the confines of their family circle. Of course, 20 percent of the estate is by no means the same thing as 20 percent of the last year's *income*, and in fact some large donors would seem likely to exceed the limit. Furthermore, it deserves notice that the 20 percent limit imposed in the year of death is in fact more stringent than the usual limit as the taxpayer cannot, for obvious reasons, carry forward any excess contributions to future years. Nonetheless, the spirit of the amendment accepts the broad "logic" of representations made to the government to the effect that abolition of a tax (the federal estate tax) should not preclude continuation in some form of deductions formerly permitted against the base of that tax.

As indicated earlier, there has from the beginning of the charitable deduction in Canada been a good deal of concern with the possibility of abuse of the system. Most of this concern has been directed at the most obvious kind of abuse, namely, the claiming of false deductions. The approach which has been taken to control this practice is to require that all specific claims for charitable deductions must be supported by receipts issued by registered Canadian charitable organizations. The administrative focus has thus shifted from the control of donations per se to the control of the organizations that receive the donations. The new income tax law carries forward and strengthens this emphasis on the registration of charitable organizations and on the requirements which must be satisfied for registration.

There were 34,682 such registered charitable organizations (plus 38 amateur athletic associations) in September 1973, with about 2,400 new organizations applying for registration each year and about 1,300 of them attaining the desired status.[42] Despite this eagerness to register, it appears that these organizations maintain the general Canadian tradition—noted earlier with respect to foundations—of being reluctant to divulge any information about their annual operations. At any rate, only a little more than half of the registered organizations file the required annual return on time, and some 2,500 of them had their registration revoked in 1971 for persistent delinquency in this regard. Despite the considerable emphasis in the law on the need for these organizations to have certain characteristics (for instance, 90 percent of their income must be spent on charitable activities), no information on them other than that noted above has been released by the government, perhaps in illustration of another honored Canadian tradition of official secrecy in as many areas as can be gotten away with. (It is only fair to add that this latter tradition, if it can be called such, is bolstered by the general lack of interest in such matters in Canada, a country long noted for its lack of indigenous muckrakers and "public interest" advocates.[43])

In any event, a recent review of the situation in Canada with respect to the taxation of charitable organizations does not seem to have been far off the mark when it stressed ". . . the obsession of the legislation with the charitable character of the recipient *organization*" and concluded that ". . . the tax administration system is more concerned about policing the organizations than they [sic] are about the charitable character of the gift."[44] The general thrust of this conclusion is reinforced by statements such as that made by the Minister of Finance (Mr. Benson) in 1971 when he announced a reexamination of the charitable deduction "to determine whether the traditional definition of charitable organizations is broad enough to reflect real need in the 1970's."[45] An interdepartmental committee was in fact apparently set up for this purpose and was reported to be still functioning in November 1973.[46] it has as yet made no report, however, or at least no public report.

Tax Treatment of Gifts of Appreciated Property

More subtle possibilities of abuse of the charitable deduction than outright fraud, of the sort which have long given rise to concern in the United States, were of little importance in Canada until recently, principally because there was, on the one hand, no tax on capital gains and, on the other, judicial interpretation appeared to render gifts-in-kind generally ineligible for the deduction anyway.[47] In sharp contrast to the United States, where since 1917 there has been clear legal provision for the deduction of gifts-in-kind (generally at "fair market value"), there was no specific mention of such gifts in Canadian income tax law before 1972. While the Income Tax Act did not require deductions to be in cash, in the early 1960s the Department of National Revenue, with the support of the courts, did not "except in special cases of substantial gifts with an accurately ascertainable value" allow gifts-in-kind to qualify.[48] When such gifts were permitted, however, they could be deducted at fair market value. By the time of the Carter Report, practices had apparently become somewhat more liberal although certain types of gifts (inventory that had been expensed and second-hand goods, for example) were clearly prohibited by regulation.[49] Nevertheless, gifts-in-kind were still very rare indeed, as was evidenced by the stir caused by a case in which a taxpayer donated a yacht to a university for research purposes and was granted a deduction.[50] The introduction of a tax on capital gains in 1972 has brought this whole area into much greater prominence.

The Royal Commission, which had recommended a much stronger form of capital gains tax than that finally enacted, had made it very clear that dispositions of capital assets by gift or bequest should be brought into income as though the assets had been sold at their appreciated value.[51] It was also made clear in the *Report* that donations-in-kind exceeding $500 in value in any year (to avoid the "old clothing" problem) should be deductible for purposes of the income tax at the same value as they were brought into income, namely, their appreciated value.

The 1971 act broadly accepted this position. Gifts-in-kind were made clearly eligible for the normal 20 percent deduction, while property passed by gift or bequest to anyone other than a spouse was deemed to be disposed of at fair market value.[52] The only exception was that depreciable property passed by bequest was to be valued at an amount midway between the fair market value of the property and its undepreciated capital cost.[53] The result of this provision could be a recapture of capital cost allowances—which would be taxable at ordinary rates under the new act—a capital gain, both the foregoing, or a claimable loss. These provisions were to apply to all gifts and bequests (except interspousal transfers) regardless of whether the beneficiary was a charitable organization or not.

The earlier discussion of the White Paper proposals had made it plain, however, that there was what the Minister of Finance later called "a general fear that gifts and bequests of appreciated property will be discouraged if there is a deemed realization of the capital gain."[54] Both the House and the Senate committees in their reports on tax reform had been influenced by representations to this effect and had suggested more favourable treatment of gifts-in-kind. In both cases, the parliamentary bodies appear to have favoured complete exemption of some (Commons) or all (Senate) charitable bequests and gifts from the tax on capital gains.[55]

There was also in the hearings before these committees some degree of acceptance of the position put forward by several participants in the tax reform discussion, notably the representatives of the private museums, that not only should the donor not be taxed on the gains, but he should also be able to deduct the fair market value of the gift for income tax purposes.[56] A principal reason for the stance taken by the museum representatives in favour of permitting deductions for "appropriate" gifts-in-kind at fair market value—preferably not subject to the 20 percent limit—as well as no capital gains tax was that the "competition," that is, the United States, offered such inducements and that Canadian museums, which were in competition with American museums for gifts of art, were falling behind because of their inability to offer similar tax incentives.[57] To quote the brief of the Canadian Art Museum Directors' Organization, "in this matter of the comparative quality of world's museums, our competition gives no quarter. . . ."[58] To the constraints on tax reform in Canada imposed by the relatively unified capital market of North America it thus appears that one must add the constraint imposed by a unified art market!

Whatever the merits of this argument—which, it should be noted, affected less than 1 percent of Canadian philanthropy even according to its proponents[59]—the government was clearly persuaded of the need to at least appear to make some response to such pressures, even though the Senate Report explicitly and the Commons Report implicitly favoured allowing deduction of the cost basis only, as had been recommended by several other witnesses.[60] The original 1971 provision requiring taxation at market value of gifts and bequests—and permitting deduction at the same value—was therefore amended in 1973 "in those cases where the property to be gifted is not a substitute for money—that is, where the property gifted to the charitable organization is suitable for actual use in its charitable activities," such as the bequest of an art collection to an art gallery.[61] The donor of qualifying tangible capital property was by this amendment given the option to claim as a deduction any amount not greater than the fair market value of the property and not less than its adjusted cost basis to him, provided that he would also be treated for purposes of capital gains tax as having disposed of the property at the same value.

Although no one in the Canadian discussion appears to have explicitly referred to the almost contemporaneous U.S. discussion of the Tax Reform Act of 1969, the system that was adopted in Canada was in fact really the same as that proposed for all tangible personal property in the House version of that act, apparently largely in an attempt to reduce the valuation problems which had long afflicted the world of art gifts.[62] After the Senate rejected this proposal (in part on the grounds that the valuation problems would still exist even if the gains were taxed), the Conference Committee adopted the so-called "unrelated use" rule as a compromise. This rule permits the market value deduction, without subjecting any gain to tax, when the donee's use of the property is "related," which appears to mean something very close to what is intended in the present Canadian law. (Whereas only 50 percent of the appreciation on "unrelated" gifts may be deducted in the United States, their full value can be deducted in Canada, although the gain is also fully taxable.) There has as yet apparently been no pressure to extend the "use" option in Canada, although some American observers have labeled the failure to grant a broad exemption for charitable transfers "the most striking feature" of the Canadian deemed realization rule.[63]

How one views this option depends very much upon what is compared with what. It is clear that by electing the adjusted cost basis, the donor can avoid capital gains tax; on the other hand, he loses the benefit of the deduction. As a general rule, it would appear advantageous for a taxpayer to opt for the highest value even though he has to pay the capital gains tax, *provided* he can deduct the full amount of the gift from taxable income. The reason is simply that he gains a $1.00 in deduction for each $0.50 added to his income because of the half-inclusion rule on capital gains.[64] On the other hand, if the taxpayer cannot make any use of the increased deduction he would obtain by choosing the high option because his other gifts have put him up to the deduction limit already, he should choose the cost basis (ignoring the carryover possibility). If the gift will bring him up to the limit, the appropriate value to choose will lie between these extremes.

This argument assumes, however, that the taxpayer is for some reason determined to give the appreciated property away. A more interesting question is whether the existence of this option has affected the incentive to give appreciated property rather than cash (or assets that can be sold by the donee for cash). Actually, one can think of the donor as having several alternatives:

1. He can give cash (out of taxed income) equal to the value of the appreciated asset.
2. He can give the appreciated asset to charity at cost.
3. He can give the asset to charity at market value.
4. He can keep his asset and his cash.
5. He can sell the asset and give the net proceeds.
6. He can sell the asset and keep the net proceeds.
7. He can give the asset to a non-charity other than his spouse.
8. He can sell the asset and give the charity the equivalent of its market value (that is, the proceeds before tax, making up the difference out of other income).

Table 8 illustrates the relative positions of the donor and the charity for a particular hypothetical situation; the possibility of a carryforward of unused charitable contributions is ignored. As the table indicates, the best option for the donor who can claim a full deduction is always to give the appreciated asset to the charity at fair market value and pay the tax. If he cannot claim any deduction at all he—though not the charity!—should be indifferent to giving the asset at cost and not giving it at all. If his position is between these extremes, he may in some circumstances be indifferent between selling the asset and giving full sales proceeds to the charity. In the general case, however, it seems clear that the new tax situation should *encourage* the gifting of appreciated assets to charities, simply because only half of the gain is taxed at ordinary income tax rates while the entire value of the gift can be deducted from income (subject to the percentage limitation). The option is in effect a

Table 8

Illustration of the Effects of Taxing Appreciated Property Gifts[a]

	Tax Saving to Donor[b]		
	(A)	(B)	Value Received by Charity
Case 1	$ 0	$-5,500	$11,000
Case 2	500	0	11,000
Case 3	3,000	-2,500	11,000
Case 4	0	0	0
Case 5	1,750	-2,500	8,500
Case 6	-2,500	-2,500	0
Case 7	-2,500	-2,500	0
Case 8	1,750	-3,750	11,000

a. Assumptions: marginal tax rate of 50 percent, in column (A) all contributions are fully deductible while in column (B) none are; adjusted cost basis of asset $1,000; fair market value of asset $11,000.

b. The tax saving is calculated as the value of the deduction (50 percent of the amount received by the charity) less the taxes paid by the donor (either 25 percent on capital gains or 50 percent of ordinary income).

device to maintain this relative incentive for those close to the deduction limit, at least up to the point at which the gift becomes completely nondeductible. While the introduction of the capital gains tax on such gifts would clearly deter them relative to a situation in which there was no such tax as in the United States, the combination of introducing the tax *and* making such gifts eligible for the charitable deduction as in Canada has tilted the balance the other way.

There are, of course, many other problems in the tax treatment of appreciated property gifts which are well known in the United States and still for the most part lurk in the future for Canadian tax administrators, such as the possibility of claiming deductions while retaining lifetime control over the property. It appears, despite a warning by the Royal Commission on this point,[65] that remainder interests can still be given in this way.[66] Ingenious tax practitioners can no doubt continue to be counted on to stay one step (at least) ahead of the Revenue.[67] For this and the other reasons noted above, one might therefore expect increased exploitation in the future of the various avoidance possibilities connected with gifting appreciated property to charitable institutions. Once again, it appears that Canada has little to teach the United States except the possibly important lesson that taxing gains on such property simply reduces, but does not abolish, these problems.

The Exemption of Charitable Bequests

Since the inception of the provincial succession duties in the nineteenth century, charitable bequests have generally been exempted from death taxes in Canada. As of 1974 the treatment of charitable bequests in those provinces in which death taxes survived (see Chapter III) was as follows.[68] Quebec's provisions are the most liberal, granting exemption to all legacies for religious, charitable, or educational purposes without limitation. All the other provincial statutes limit the exemption in some way. Ontario, for example, grants exemption only to the extent that the organization concerned carried on its work in Canada. While Saskatchewan and Manitoba both exempt bequests to registered Canadaian charitable organizations (that is, those registered for federal income tax purposes, which does not mean they need to carry on their work in Canada), the latter further limits the exemption of charitable bequests (not *inter vivos* gifts) to the greater of 20 percent of the aggregate net value of the estate or $150,000 less the total value of all successions by preferred successors.[69] The strictest limitations by far, however, are found in British Columbia, where bequests and gifts to registered charitable organizations are restricted to 10 percent of net value and then only if the property is devoted exclusively to charitable activities within British Columbia. The restrictions on the amount of charitable exemptions in both Manitoba and British Columbia have been attributed to the fact that "the prevailing political philosophy would seem to attribute relatively less importance to private enterprise."[70] Why Saskatchewan, which also has a socialist government, does not similarly indulge its prejudices is not explained by this approach. Presumably, the territorial limitations in most of the statutes reflect the belief that charity not only begins at home but should stop there too.

The narrow definition of the scope of charity in British Columbia is somewhat alleviated by the fact that artistic works and artifacts passing to public institutions in British Columbia are exempt from duty and valued nominally at one dollar for all purposes of the act. Ontario in effect provides similar treatment to *all* charitable bequests since they are excluded from the estate for purposes of calculating the appropriate rate of duty applicable to taxable bequests. The result, as the Ontario Committee on Taxation noted in 1967, is that by making a charity the residuary legatee it is possible to reduce the duties paid by other successors.[71] The committee considered this result inequitable and unneutral and therefore recommended the introduction of the system used in the then federal estate tax, under which property going to a charitable body was exempted only after taxes were paid.[72] Although the data in Table 5 suggest that few estates in Ontario made charitable donations for any reason, good or bad, this same point was taken up by the later Ontario Advisory Committee on Succession Duties, which recommended in contrast that the existing system be continued and even that the practice of charitable remainders be encouraged, while taking some measures to reduce the obvious tax avoidance possibilities.[73] Indeed, in its concern for "things of beauty, symbols or artifacts of our history" which are "capable of uplifting and inspiring generations of Canadians," the committee went quite a bit further in its efforts to persuade the wealthy to leave their possessions for the public, by proposing that the owner be permitted to get the tax exemption even though the gift (or bequest) was subject under certain conditions to up to two following life interests.[74] Apart from the stipulation that the remainderman must be an institution of the federal or provincial government, the system envisaged by the committee would apparently work very much like that which exists in the United States—and has been so often criticized.[75]

Attitudes towards Philanthropy

It was noted at the beginning of this chapter that there has in general been remarkably little discussion or justification of the various changes that have been made over the years in the tax measures affecting philanthropy. The attitudes reported above are not a summary of what has been said on this subject in Canada in the course of the tax debate: they *are* more or less what has been said. A mildly favourable but very vague official attitude towards philanthropy, coupled with some concern about the possibility of abuse, emerges from the preceding discussion, as does the expected concern about the possibly adverse effects of the tax reforms on giving on the part of representatives of recipient groups such as museums and universities.[76] These attitudes are not surprising, nor are those of other groups more critical of the role of the private philanthropic sector, which characterize corporate philanthropy, for instance, as "morally deceptive"[77] or which suggest that an unlimited charitable deduction might be misused ". . . for the adoration of the individual in establishing memorials to himself which might well have limited social value for the broad number of Canadians. . . ."[78]

It is perhaps more surprising, and for that reason more interesting, to find even experienced tax practitioners making statements such as the following from a well-known accountant: "A lifelong attachment to their wealth seems characteristic of Canadians. Those few who do give, often create the impression that their real motive is to do Revenue in the eye."[79] This note of skepticism about the significance and propriety of the whole charitable game is even more marked in a remark attributed to "an experienced Toronto lawyer": "In the first place, one has to realize that there is no element of virtue in creating a charitable trust by a testamentary instrument. Since no one . . . claims to have discovered a method by which the advantages of wealth can be carried over in the next world, it is clear that anyone who is being charitable by will, is being so with somebody else's money and is actuated by vanity, that is by a belief that he knows better than future living persons what will be good for the community."[80]

That the attitudes expressed in these last quotations go well beyond the official view is suggested by some remarks made some years ago by Louis St. Laurent, then Prime Minister of Canada, in a debate concerning the reasons underlying the creation of the Canada Council (a body approximately equivalent to the National Science Foundation, although it looms much larger in the Canadian grant scene because of the absence of private competitors) with an endowment of $50 million for the "encouragement of the arts, humanities and social sciences." Because Mr. St. Laurent's remarks contain, despite their meandering nature, the fullest discussion at his political level of the relation between private philanthropy, public largesse, and estate taxes which appears to exist, they warrant quotation here:

> I might say that one of the considerations which I had in mind—it was not the governing consideration—was the fact that there had been at the time we were preparing this recommendation for parliament two very unusually large estates [those of Isaak Walton Killam and Sir James Dunn] from which the collections of succession duties had been made in amounts that could not be considered to be recurring amounts. In connection with one estate the statement had been made more than once by the deceased during his lifetime that he was not making any provision during his lifetime or apt to make any under his will for benefactions to public institutions because the succession duties were so high, the proportion of his estate which would be taken in succession duties, if it were thought fit, could be employed on the recommendation of the government by parliament for like purposes. In the case of the other estate it is not to my knowledge that the deceased had made a similar declaration, but it is to my knowledge that he made modest contributions to institutions of the character of those envisaged by the legislation.[81]

Surely it is rare for the elected leader of a country thus to publicly justify his government's use of the taxes collected from particular estates for "charitable" purposes in part on the grounds that the deceased would have liked it that way! If nothing else, this quotation serves to remind us that Canada is, after all, a small country in many ways—a fact which comes up again in connection with the current state of death taxes in the Atlantic provinces, as seen in the next section.

The Prime Minister's statement also conveys something of the flavor of Canadian attitudes to wealth. As Seymour Lipset put it some years ago in a fascinating comparative study of the value systems in the English-speaking democracies, "Canadians have always been less intolerant of economic inequality" than Americans.[82] This attitude showed up clearly in the recent death tax "reform" (see below) when no official voice or significant public outcry was raised while death taxes were substantially reduced. Even in provinces such as Manitoba, where the previous Conservative government's stated intent to abolish the death tax was a (minor) election issue, the newly elected socialist government quietly acquiesced in the effective lowering of taxes at death, as did its sister socialist governments in Saskatchewan and British Columbia. No voice of radical principle or even mild egalitarianism was heard in the land, nor should one have been expected in view of the calm acceptance of inequality by most citizens which has long characterized Canadian society.[83]

III

CAPITAL GAINS TAXES AND DEATH TAXES

The Debate on Capital Gains

Capital gains were not taxed in Canada until 1972. Prior to that time, the pros and cons of taxing capital gains under the income tax had, of course, long been discussed. But the first full-fledged and at least semi-official proposal to tax gains was that made in the Report of the Royal Commission on Taxation, which appeared in early 1967.[84] The commission more than made up for the past neglect of capital gains taxation by proposing as one key part of its comprehensive reform of income taxation to tax gains at the ordinary income tax rates not only when they were realized but also when appreciated assets were given or bequeathed outside the proposed family unit (or the taxpayer gave up Canadian residence).

As might be expected, these proposals gave rise to a tremendous public discussion, with academics for the most part favoring them and "taxpayers"—or at least that select group of taxpayers which gets heard on such occasions—being against them. (Interestingly, much of the attack on capital gains was in fact disguised as an attack on the closely related proposal for the integration of personal and corporate taxes, a proposal which in itself would have favored many of its most vociferous opponents.[85]) In view of the relative weight which appears customarily to be given the opinions of these two groups in the Canadian political process, it is somewhat surprising that the Carter proposals for taxing capital gains at realization like any other form of income reappeared, relatively unscathed, in the government's White Paper on tax reform in 1969. Furthermore, deemed realization at gift and on giving up Canadian residence also reappeared, although the family unit concept had been dropped. Deemed realization at death, however, was dropped in the

White Paper, instead, there was to be a carryover of basis (plus death duties applicable to any accrued gain) at death. The stated reason for this change was to avoid the possibility of two taxes—the capital gains tax and the estate tax—applying at the same "most inconvenient time."[86]

This White Paper variant on Carter was, of course, immediately attacked by knowledgeable observers, who pointed to the various problems (notably the increased lock-in) to which such a caryover of basis would give rise and advocated a return to the deemed realization at death proposed by the Royal Commission.[87] During the hearings on the White Paper proposals it quickly became apparent that most witnesses had either been convinced by such arguments or thought for some other reason that the White Paper's deferral of accrued capital gains at death would not in fact be enacted. Even a number of business-oriented witnesses therefore suggested that the carryover should be replaced by deemed realization at death. This suggestion, however, was almost invariably accompanied by some proposal to reduce the burden of the estate tax, either by lowering its rates or—the favorite of most—by eliminating it completely.[88] It thus became apparent that a key issue in the debate was the *level* of taxes levied at death.

This theme—the linking of the taxation of capital gains at death and the death tax per se—which was, as seen above, presaged in the White Paper itself, carried through to the reports of the House and Senate committees, with the former recommending the reduction of the estate tax and the latter its eventual abolition (even though they also recommended against deemed realization too). The other recurrent theme in the testimony of the business and investment community—for favorable rates on capital gains tax in any case (usually at half the ordinary rates)—also emerged in both committee reports. All in all, as a leading tax accountant noted in 1970, "the only way in which large sections of our business community seem prepared to adopt any change is if the change proposed is either so heavily watered down as to make it completely ineffectual, or else the change can be shown to be something that the United States did 20 years ago."[89]

The capital gains tax which finally emerged out of all this discussion bears witness to the truth of this observation, for it resembles nothing so much as the tax which has long been in existence in the United States. Certainly, it is much closer to the U.S. model than to that set forth in the Carter Report.[90] One notable difference, however, is that nine of the provinces share in the proceeds of the capital gains tax (as they do in all personal income taxes), while the tenth (Quebec) has enacted a very similar tax on capital gains as part of its own income tax.

In general the 1971 act provides that half of realized gains are to be reported as income and taxed at the applicable personal or corporate rate. Half of realized capital losses may be offset against the half of gains currently taxable. In addition, individuals are permitted to deduct up to $1,000 of any excess allowable loss against other income of the same year. (The $1,000 limit does not apply in the year of death.) Any unabsorbed losses may be carried back one year and then forward indefinitely in the same manner. The general rules also provide for deemed realization of accrued gains to occur at death,[91] when an asset is gifted, and when the owner gives up Canadian residence. Capital gains on gifts and bequests passing to a spouse are deferred, however, and the basis is carried over until the spouse disposes of the asset, or is deemed to do so.

In addition to the general interspousal exemption, capital gains realized on a taxpayer's principal residence and up to one acre of surrounding land are not taxable. Farmers have the option of deducting $1,000 for each year after 1971 they have owned the farm and during which their principal residence was on it, against gains realized from the sale of farm property. Finally, a gains realized on personal-use property are taxed only if the proceeds exceed $1,000; if they do, the cost basis of the asset is presumed to be not less than $1,000.

At no point in the entire Canadian discussion was it seriously proposed to tax retroactive gains. Assets are therefore valued as of a "Valuation Day" of December 22, 1971, for shares traded on Canadian markets, and December 31, 1971, for all other assets. Individual taxpayers have the choice of two methods for determining the base value of assets owned on January 1, 1972, with reference to which gains and losses are determined, with the restriction that the election made the first time gains or losses are reported is binding for all future dispositions. The first alternative base for determining gains and losses is the fair market value on Valuation Day. The second, which most taxpayers would probably use (and which corporations must use), is the "tax-free zone" method under which gains are based on the greater of historic cost or Valuation Day value, while losses are based on the lesser of the two.

Apart from the important provision for deemed realization at death, this system resembles the present U.S. system more than it does that envisaged in the Carter Report. Moreover, a substantial price was paid for this advance (if it be considered as such) in that a concomitant of deemed realization at death was the abolition of the federal estate and gift taxes, with the further result that death taxes are well on their way to vanishing in much of Canada.

Two factors appear to account for this unanticipated result. The first is that, as suggested earlier and developed in the next chapter, there has never been much force behind the egalitarian argument for death taxes in Canada. The second is that, as indicated above, deemed realization at death was seen by many, including the government itself, as in effect a substitute for death taxes. Few were as logical about the relation between the two as R.D. Brown, who argued that estate taxes should be reduced when capital gains were taxed at death, but went on to note that the estate tax should certainly not be eliminated on this account because it was really quite a different tax. "In any event," Mr. Brown said, "the government will be quick to visualize the horrible prospect of a multi-millionaire putting all his funds into government bonds so that he will never realize any further capital gains, and then transmitting his property from generation to generation, and it will likely argue that some toll on the transmission of wealth between generations should be retained."[92] As it turned out, the government was not so quick as all that, or at least was not unduly concerned with the sort of problem Mr. Brown envisaged.

Death Taxes: A Casualty of Tax Reform

The first death taxes levied in Canada took the form of succession duties imposed by four provinces in 1892. Subsequently, all other provinces introduced similar duties. As a rule, these taxes, while modeled after the inheritance taxes enacted earlier in New York and Pennsylvania, imposed rates in accordance with the aggregate value of the estate, with the rates varying by class of beneficiary as well as by the size of the individual legacy.[93] When estates were subject to tax in different provinces the application of this complex structure gave rise to considerable difficulty, and was a cause for concern in the 1930s. Most problems in this area, however, were resolved after the federal government imposed a death tax in 1941. (A federal gift tax had been imposed earlier, in 1935.) The federal tax too took the form of a succession duty until it was changed to an estate tax in 1959. In exchange for a "rental" payment from the federal government equal to the revenues they had collected in 1940, all provinces renounced their succession duties for the wartime period. After the war, only Quebec and Ontario again levied their own inheritance taxes, in much the same form as before, with credit being given for these taxes against the federal tax up to a maximum of one half the latter. The other provinces continued to receive a share (for many years, 50 percent) of the federal estate tax collections which were allocated to them.[94] In 1963, however, British Columbia withdrew from this agreement and reintroduced its own succession duty, largely on the grounds that the province had been losing revenue owing to the particular way in which the situs rules of the federal act operated.[95] The next year, when the federal government increased to 75 percent the share of the estate tax yield going to the provinces, both Ontario and Quebec accepted 25 percent of estate tax collections on a direct federal payment. British Columbia, however, increased its succession duty rates to pick up the full 75 percent abatement and also took the occasion to introduce a considerably simplified rate schedule.[96]

The situation at the time of the Carter Report in 1967 was therefore that the federal government levied an estate tax but paid 25 percent of the yield from provincially domiciled estates to all provinces except British Columbia and an additional 50 percent to all other provinces except Ontario and Quebec. These three provinces levied their own succession duties, with the duty being credited against the federal tax up to a maximum of 50 percent (Ontario and Quebec) or 75 percent (British Columbia). This structure is depicted in Table 9, which shows that total death taxes collected in 1966, for example, were $219 million, with $118 million being collected directly by the three taxing provinces ($58 million by Ontario alone) and the balance by the federal government, with the latter transferring close to half the proceeds to the provinces (for example, $20 million to Ontario).

Against this background, the Carter Commission Report recommended in early 1967 that gifts and bequests be henceforth treated like any other form of income to the recipient—and, incidentally, that the separate taxes on gifts and estates be dropped.[97] Shortly after the Royal Commission reported, two significant events took place in the death tax field. The first was that the Province of Alberta (which has sometimes been called "the Texas of Canada") introduced in 1967 an Estate Tax Abatement Act, by which, in effect, that portion of the federal estate tax on Alberta estates which was transferred to the province by the federal government was to be rebated to the estates by the province. Death taxes in Alberta thus became at most 25 percent of those levied elsewhere in the country. A similar step was taken by Alberta's neighbor, Saskatchewan, in 1969. Furthermore, the third prairie province, Manitoba, also announced its intention to rebate estate taxes in that year unless the federal government resolved this "competition for economic advantage" satisfactorily[98]—although in fact Manitoba did not do so, mainly because a socialist government came to power in that province in the interim.

The second event, which appeared even more significant at the time, was that the federal government substantially revised its transfer tax system in 1968 by exempting interspousal transfers, raising rates on other transfers to maintain revenues, and integrating estate and gift taxes into a cumulative progressive tax. In taking this step, the government appeared to have decisively rejected the Royal Commission's argument for taxing bequests and gifts as income. Nevertheless, though far less radical than the Carter proposal, the changes, particularly the rate increases, gave rise to considerable public outcry, to the point where it appears the whole experience may have made the government particularly sensitive to this area when designing its major tax

Table 9

Revenues from Death Taxes, 1956-1973
(in millions of dollars)

Year	Federal Estate Tax Collected	Amounts Transferred to Provinces	Provincial Death Taxes Collected	Total Death Taxes Collected	Proportion of Revenues Going to Federal Government (percent)
1956	$ 79.7		$ 64.6	$144.3	
1957	71.6		52.6	124.2	
1958	72.5		55.8	128.3	
1959	88.4		56.2	144.6	
1960	84.9		60.5	145.4	
1961	84.6		65.9	150.5	
1962	87.1	$16.6	72.0	159.1	44.3
1963	90.7	10.5	85.7	176.4	45.5
1964	88.6	40.9	92.2	180.8	26.5
1965	108.4	42.7	107.9	216.3	30.4
1966	101.1	48.1	117.6	218.6	24.2
1967	102.2	55.4	109.3	211.5	22.1
1968	112.4	55.5	121.9	234.3	24.3
1969	100.6	59.9	140.5	241.1	16.9
1970	119.8	60.4	158.1	277.9	21.4
1971	132.0	65.9	137.9	269.9	24.5
1972	60.9	12.4	160.0	220.9	22.0
1973		-	133.9	196.0	N.A.

Sources and notes: All columns are based on Statistics Canada data on the consolidated Government Finance basis and refer to the fiscal year starting in the calendar year indicated. The figure for "provincial death taxes collected" in 1973 is an estimate from official sources: it appears to be too low according to the partial actuals now available. After 1967, some of the federal taxes transferred to the provinces were in fact rebated to the estates concerned so that the net tax collections were slightly less than those shown.

reform over the next few years. Be that as it may, in 1969 the federal government once again made a strong statement on the need for a strong federal role in the death tax field.[99] Six reasons were given in support of this case: (1) Parliament must retain its constitutional right to impose such taxes, which were, besides, "a reasonable and an equitable way to raise public revenues";[100] (2) death taxes had to be linked to gift taxes to avoid evasion and only the federal government could really do this; (3) death taxes also acted as a check on income tax avoidance; (4) the federal death tax limited the chances of avoiding the death taxes of those provinces that imposed them; (5) it also enabled the collection of the tax for those provinces that did not want the complications of levying their own; and (6) only the federal government could deal with the international aspects of death taxation.

In light of this position, it was thus a complete surprise to everyone when the federal government announced in 1971 its decision to vacate the estate and gift tax field completely at the end of the year. Three reasons were offered for this decision: the abatement movement in the prairie provinces, the low revenues received by the federal government from estate taxes (see Table 9), and, most important, the desire to avoid "substantial tax impact arising on the death of a taxpayer as a result of the new capital gains tax on deemed realizations at death."[101] The first of these factors was said to make national uniformity impossible anyway, while the second factor was considered to make it impossible to adequately allow for the third, short of abolishing the whole tax. While the federal government subsequently offered to continue to collect succession duties for those provinces which decided to re-enter the field for a period of three years, provided at least four provinces imposed more or less uniform taxes, the nature and firmness of its decision to leave the death tax field completely was made crystal clear by one condition imposed on those who would take advantage of this offer: "that the presentation to the public would make clear that it is a provincial not a federal tax."[102]

The academic reaction to this action was, as might be expected, generally one of surprise and of denial of the postulated connection between death taxes and capital gains taxes levied at death.[103] Yet in the light of hindsight, there was already a good deal of evidence on hand demonstrating that Canadian taxpayers and politicians alike *do* in fact see a clear connection between these levies, whatever the economist might say. In addition to the various references cited earlier, even a minority report to the Royal Commission Report had labeled the situation "double taxation."[104] Although made little of at the time, Mr. Beauvais's attitude turned out to be more representative of that of the bulk of "informed Canadians" (to use one of the commission's favorite terms) than the cavalier disregard of this position in the majority report.

One reason for this politically potent reaction appears to be that the only accepted rationale for death taxes in Canada has always been simply revenue. While more far-reaching social purposes have occasionally been mentioned—once in a while even by official sources—on the whole it is clear that revenue is the main purpose of death taxes so far as most Canadians and Canadian governments are concerned. Another reason for this reaction appears to have been that another accepted rationale for taxing at death was simply to make up for some of the inadequacies of the income tax which had been levied during life: this point of view was expressed, for example, in the 1969 federal defense of the federal death tax cited above. In an earlier discussion in 1940, the Royal Commission on Dominion-Provincial Relations had put the position very simply: "capital gains are best taxed through the succession duties."[105] It follows from these arguments that when capital gains were taxed directly, as in the 1971 act, there was much less need for death taxes for either revenue or "catch-up" reasons.[106] Whatever the explanation, it is clear that none of the Canadian academic proponents of taxing capital gains at death gave sufficient weight to the strong political pressures which quickly emerged to offset this "new" tax by getting rid of the ancient death tax.

That these pressures did not stop at the federal level was clearly demonstrated by the subsequent peregrinations of the provincial succession duties. The immediate reaction of most provinces was one of great uncertainty, even though some of them—notably Quebec[107]—had long urged the federal government to leave taxation to the provinces. Ontario's reaction to the federal move was particularly interesting and is discussed at more length below. Alberta having already in effect opted out of the estate tax, was indifferent to the whole issue and decided to stay out of the death tax field completely. Saskatchewan, however, where a socialist government had recently come to power, decided to join Manitoba and the four Atlantic provinces in imposing a new, more or less uniform death tax, which the federal government had, as noted above, offered to collect for them, under certain conditions, for three years. It is worth noting that, according to an authoritative account rather than social philosophy, "revenue considerations were of primary concern to these six provinces; they concluded that they simply could not afford to give up this source of revenue."[108] This was particularly true in the case of the poor Atlantic provinces, which were very apprehensive about getting into the death tax field in the first place and which imposed the new tax only as a transitional measure "until capital gains take full effect."[109]

In 1972, then, the federal government was collecting a new "uniform" succession duty for six provinces, three continued to levy their own duties, and one (Alberta) had no death tax at all. Although in all cases except that of Ontario, where the provincial rates were raised to make up for the federal withdrawal, the new death tax rates were generally lower than those before 1972 (see Table 9), it appeared that what had happened was not too important after all because in effect the provinces had made up for the federal lapse in this field. The situation was by no means static, however. Since 1972, for instance, all four Atlantic provinces, terrified, it appears, by the prospect of capital flight,[110] have withdrawn from the death tax field. In fact, Prince Edward Island never even collected the tax in 1972, and its early withdrawal led directly to that of the three neighbouring provinces, apparently largely for competitive reasons, for fear of loss of investment to the island "tax haven."[111] Several of the other taxing provinces have substantially reduced the rates of their succession duties or raised the exemptions. British Columbia, for example, raised exemptions in 1972, as did Quebec in 1972 and 1973, Saskatchewan in 1974, and Ontario in 1973 and 1974. Quebec also reduced rates by 20 percent in 1973 and by another 20 percent in 1974.[112]

The situation at present is thus that there are succession duties in only five of the ten provinces, although admittedly these are the five of the largest provinces. Even for these provinces the situation is far from certain since at various times Quebec, Ontario, and British Columbia have all announced their intention to vacate the succession duty field in the future, although Ontario has recently changed its tune in this regard and the recent election of a socialist government in British Columbia has presumably rendered the previous announcement inoperative there also. What will happen over the next few years thus remains quite uncertain, but it seems highly improbable that the general downward trend in death taxes will be reversed. It is thus clear that the result of the federal abandonment of the estate tax has been considerably increased national disparity in death taxes, on the one hand, and a substantially lower level of death taxes, even in those provinces that retain them, on the other (see Table 9).

A few years ago, a U.S. Treasury paper argued that "the failure to see clearly that the estate and gift taxes are not substitutes for income taxes has led to adoption of rules with regard to property transferred at death which subverts the goal of income taxation."[113] Ironically, it seems that precisely the opposite criticism—that the failure to see clearly that the income tax is not a substitute for the estate tax has led to policies which have subverted the entire Canadian death tax system—may be made in Canada, not only with regard to what has in fact happened, but even with regard to the august and impeccably academic Carter Report which followed, albeit for very different reasons, a long-standing Canadian tradition in failing to recognize any separate role for death and gift taxes apart from that of the income tax.[114] It seems unlikely that either the Royal Commission or any other proponent of improving the income tax by taxing capital gains at death thought that a death blow to death taxes would be the price that would have to be paid for this reform. Indeed, most of those who have argued for taxation of deemed realizations seem to think it would be a "costless" improvement.[115] In Canada at least, those who thought this way have clearly been proved wrong.

As was noted about the furore aroused in 1969 by the relatively minor federal death tax revisions which took place then, the reaction to such measures cannot, it appears, be understood in narrowly "rational" terms alone.[116] Much of the emphasis in the discussion on deemed realization (see Chapter IV) on the particular problems of family business and farms, for example, may have reflected the fact that many Canadians really have a dynastic rather than nuclear concept of the family: they do not, that is, agree with the traditional wealth-redistributing objective of death taxes. Attitudes along these lines, which were certainly expressed at least implicitly many times in the course of the tax reform debates, could well explain the very strong observed resistance to increasing the taxes levied on the occasion of death. The fact that the reaction went so far as actually to *lower* the taxes paid at death for most estates can perhaps similarly be explained in part by the considerable sensitivity to the whole issue of death and taxes which had been stimulated in Canada by the very recent federal changes: the wounds caused in 1968 had not had time to heal before the "double whammy" of 1969[117] opened them up again—and the continual discussion of this point through 1970 and 1971 exacerbated the felt hurt. All in all, the whole episode illustrates the importance of fiscal psychology as well as economic fact in the design, presentation, and implementation of tax reforms. Those who would introduce a tax on deemed realizations should, it appears, clearly be aware of the "psychological distaste for a capital gains tax at death"[118] which was so clearly revealed in the Canadian experience.

The Case of Ontario

Ontario is Canada's most populous and wealthy province, accounting, for example, for 45 percent of the total federal estate tax assessed on Canadian-domiciled estates in 1971.[119] Both because of its dominant role in the country and because the province has long been governed by the Conservative party, relations between the federal Liberal government and Ontario have often been somewhat strained in recent years. One arena in which some of this strain was revealed was that in which the question of the relation between the capital gains tax and the death tax was fought out. Ontario's shifting attitudes on death taxes in relation to capital gains taxes therefore make particularly interesting, if somewhat baffling, reading. The story is spelled out here in some detail both because it is fairly well documented and because it reveals concretely many of the attitudes discussed in more general terms in the preceding section.

More or less contemporaneously with the federal Royal Commission on Taxation, the Ontario government appointed its own taxation committee, which also reported in 1967. This report, a generally reasonable and well-argued document in most respects, contained an interesting analysis of wealth taxes. It was noted, for example, that a reasonable taxation of wealth in general, and death taxes in particular, had a significant role to play in controlling extremes of wealth.[120] While unexceptionable, this passage is nevertheless noteworthy as being perhaps the most explicit non-revenue rationale ever put forward under official auspices in Canada for taxing wealth at death.[121] The report went on to make detailed proposals for the revision of the Succession Duty Act (which, it will be remembered, was in form very similar to that first introduced in 1892), and to suggest that the federal government should withdraw from the death tax field completely, basically because it got little revenue from this source anyway.[122] The recommendations of this committee were considered in detail in 1968 by a Select

Committee of the Legislature, which generally agreed with this part of the report—as, it turned out later, did the federal government itself, at least so far as its withdrawal was concerned.

Nevertheless, in 1969, following the revision of the federal estate tax, the province proposed to take the opposite path to that recommended by the commitee and to relinquish its own succession duty in exchange for 75 percent of the revenues from the federal tax. At the same time, however, the provincial government noted that *all* death taxes should be eliminated "as capital gains taxation becomes fully mature in the years ahead."[123] The capital gains taxes referred to here were those which the province had announced its intention of imposing as part of its own income tax. Shortly thereafter, the federal government came out with its own capital gains proposal, which initially included periodic accrual taxation of share gains. Ontario immediately criticized these proposals as not involving "compensating changes in estates (sic) taxation, which we believe is in critical need of reform in terms of the total taxation of wealth."[124] "Our principle is simple," said the Ontario Treasurer, "if capital accumulation is taxed on a pay-as-you-go basis it should not be taxed again heavily at death."[125] As "immediate relief"—from the debilitating effects of contemplating a capital gains tax?—the province in 1970 therefore increased exemptions for spouses to $125,000 from the previous $75,000.

By the following year, when the federal withdrawal from the death tax field had been announced, the province continued to be concerned with the need "to establish a connection between estate taxation and capital gains taxation." It therefore announced its intention to stay in the death tax field in order to make its weight felt with regard to this connection and also to get a fair share of the revenue.[126] Although the intention to eliminate the succession duties within five years in order to avoid "confiscatory taxation of wealth" was reaffirmed, the reduction was to be gradual and progressive. Later, in 1971, the spousal exemption was doubled (to $250,000) and several other changes were made presumably in furtherance of this goal—and also to benefit small firms and family farms.[127] By the end of 1971, the provincial government had decided to make up for the federal withdrawal by doubling its own tax rates in order to make up for the lost revenue and also, interestingly enough, "for equity reasons," namely that the capital gains tax was not yet fully in operation.[128] The anomaly of a Conservative government being the only one in Canada not to lower death taxes—as all the socialist provincial governments in effect did by not raising the rates to offset the federal withdrawal—appears to have struck no one. To soften the blow, however, the general exemption was raised to $100,000 and the spousal exemption to $500,000, reducing the number of dutiable estates to about 2,000 a year. Ontario's reactions continued to be somewhat guarded in 1972: although the policy of reducing the level of succession duties as the capital gains tax matured was restated, no changes were actually made and a special advisory committee was set up to examine the succession duty field.[129]

This advisory committee reported early in 1973. Its report can best be described as a curious one. To begin with, the committee—which consisted almost entirely of lawyers and accountants—simply accepted that the capital gains tax plus the succession duty constituted a "double tax burden."[130] The best way to alleviate this problem, it was seriously suggested, was for the federal government simply to eliminate deemed realization at death and allow either a tax-free transfer at death or the carryover of basis.[131] A less desirable, but presumably more feasible, solution was to allow a credit against the succession duty for taxes paid on deemed realizations (and recaptured depreciation). Interestingly, the opposite solution—the crediting of death taxes against capital gains taxes—had been considered by the Commons Committee and rejected on the grounds that it would make the deemed realization proposal pointless.[132] One may perhaps infer that the advisory committee had a similar end result of duty and liberalization of the exemptions, especially for farms, as well as an extension of the payment period to 10 years (with interest at the general borrowing rate).

In short, the entire report was overwhelmingly concerned with solving "the problem of the deeply felt burden of two, separate, unintegrated, different death taxes."[133] What makes this line of argument particularly hard to follow is that the report itself makes it clear that *at most* very few estates were likely to encounter any substantial tax or liquidity difficulties. Appendix C of the report, for example, which reports on a study of all estates in 1970 and 1971 (when many more estates were taxed than in later years), found almost no evidence at all of the oft-alleged tax-induced sales of family businesses and firms.[134] But this evidence is not cited in the body of the report itself, which instead appears to be concerned entirely with the (totally undemonstrated) possible deterrents to "active risk-taking enterpreneurs," of whom there are said to be "only a few." Yet these are clearly the vital few in the committee's eyes, for whose benefit and nurture the entire death tax system needed to be restructured. In thus ignoring its own evidence, the Advisory Committee followed the precedent set by other commentators on this subject:[135] facts, it appears, can never shake beliefs.

Without responding explicitly to this report, the government felt it necessary to restate yet again in its 1973 budget the policy of decreasing death taxes both because of the "undesirable impact on small businesses, family farms and Canadian ownership" and because other provinces were already vacating the field.[136] In addition, several further alleviations were introduced, some of which followed lines suggested by the Advisory Committee. In the first place, complete interspousal exemption—as in the federal capital gains tax—was introduced. Second, a system of gradual forgiveness of succession duties on farm assets over a 25-year period was initiated, provided that the farm continues to operate as a working family farm. Third, farmers were also permitted to make a once-in-a-lifetime gift of up to $50,000 of an interest in a family farm to their children, free of gift tax. Finally, family firms were given six years to pay the duty, with the option of paying in shares at the fair market value (the shares to go to the Ontario Heritage Foundation).[137]

By 1974, although there was a complete (and completely unexplained) reversal of the stated goal of policy in this area—"we intend to continue to tax large accumulations of wealth"[138]—in fact the direction of change continued to be liberalization, with estates of less than $150,000 (compared with the previous $100,000) being exempted and various exemptions for dependents being increased, as was the scope of the forgiveable farm duty introduced in the previous year. In short, after five years of saying the opposite, Ontario has apparently completely reversed its general position on the independent role of death taxes, at least in principle. In practice, however, it has continued to lighten the burden of such taxes in response, on the one hand, to the usual family farm and firm arguments, and on the other, to its long-held belief that capital gains taxes and death taxes are at least partial substitutes. While only a fool would predict the future, it seems fairly safe to say that whatever the changes in the political rhetoric, Ontario seems unlikely to increase its death taxes in the near future. In this, as we have seen, it seems not atypical of the other provinces which still have such taxes.

IV

THE IMPLEMENTATION OF DEEMED REALIZATION

The taxation of capital gains at death has long been considered by many in the United States to be either impractical or undesirable. The arguments which have been put forth in support of this position have recently been conveniently summarized under seven headings: (1) constitutionality, (2) no traditional realization event, (3) liquidity, (4) deterrent to wealth accumulation and investment, (5) compounding the tax on inflation, (6) regressivity, and (7) basis problems.[139] This framework is used here to review the Canadian experience with the implementation of deemed realization both because all the arguments that have been raised in Canada can be accomodated within it and because doing so makes plain some of the relevant differences between Canada and the United States.

The constitutional issue, considered "the most important attack on a proposed gains tax at death" in the United States,[140] is of course one of the principal differences since there simply is no such issue in Canada. Indeed, the only mention of the constitution encountered in the entire literature reviewed here came in a 1969 statement by the federal Minister of Finance in which he put forward as an argument for the federal presence in the death tax field the notion that "Parliament's power under the Constitution to impose taxes ought not to be reduced unless powerful reasons are advanced for doing so."[141] Two years later, as seen above, the same Minister appeared to be convinced that these "powerful reasons" had indeed been found.

The second argument put forward against deemed realization at death is that death is not a traditional realization event. Fundamentally, the point here appears to be that "Americans are accustomed to viewing income from this liquid-ability-to-pay perspective."[142] As suggested earlier, the same appears to be true of many Canadians. Not the Haig-Simons concept of broad income—the comprehensive tax base of the Carter Commission—but the simple flow-of-money concept as the appropriate tax base appeared to be in the minds, if not on the tongues, of many of those who testified or commented on the tax proposals at various stages. As the Commons Committee put the point, albeit with reference to the White Paper proposal for a quinquennial revaluation of shares rather than deemed realization at death: "The tax system is based on the realization principle so that this is an exception to a generally accepted rule, and there should be stronger reasons for adopting it than have so far been presented."[143] Nevertheless, except in the form of the constantly reiterated concern with liquidity (see below), this argument received little explicit attention in Canada, perhaps because the long discussion in the United States appeared to have convinced almost everyone that a capital gains tax which allowed tax-free transfers at death was so undesirable that some recognition of gains at death was an essential part of any capital gains tax.

The third problem, liquidity, undoubtedly caused the greatest concern both before and after the passage of the tax reform act, even though the exemption of all gains accrued before the end of 1971 presumably gave ample time to taxpayers to plan for any forthcoming liquidity squeeze. This concern was particularly marked with respect to family firms and, especially, farms, both because of the almost mythological value attributed to these components of society and because of the considerable valuation problems in these areas.[144]

The immediate reaction of the Ontario government in 1971, for example, was, as shown above, to relieve the liquidity strain allegedly caused by levying two taxes—the capital gains tax and the succession duty—at the same time. Even further measures in this respect were urged by the special advisory committee which reported in 1973, even though its own report clearly showed the relative unimportance of the liquidity problem on which so much emphasis was being placed. Similar recognition of the practical unimportance of the problem similarly had no connection with the conclusions drawn by other commentators as to the "need" to modify the implementation of the new law because of its liquidity effects. One and all appeared to agree that, for some unexplained reason, the fact that the occasional family firm, or even worse, farm, might be forced to sell to pay taxes—even though in most cases the combined burden of the two taxes would at least for some years be less than that of the former death taxes alone—was quite enough reason to modify the legislation, or even to get rid of one of the taxes in question. Curiously, while most of those who argued this way were quick to recognize that the carryover of basis under the interspousal exemption would accentuate the liquidity problem in the long run, few noted that in most cases the taxes levied at death after the 1971 reform were in fact less than those before the reforms (see below).[145]

Whatever the merits of the case, it is clear, as shown in the previous section, that concern for the liquidity effect was a principal reason underlying the federal abandonment of the estate tax. It was also one important factor behind the subsequent reduction and, in half the country, abandonment of the provincial succession duties as well. The fact that there were apparently few "hard cases" of the sort envisaged in the usual horror tales weighted less heavily in the political balance than the fact that there were any—or even could be any. The precise reason for this great emphasis on a relatively minor component of the tax base is hard to discern. It could be, of course, that "small business" is simply code for the quite understandable opposition of the wealthy. But this does not explain the obvious widespread support for this position from a broad segment of the population, most of whom would never be lucky enough to have the chance to pay death taxes. This broader support appears in part to be closely related to some mystique (generally not very clearly articulated, but none the less real) of "small business" and the "family farm" as the backbone of the country in some sense. Once again a logical approach to this issue, whether in the United States[146] or Canada,[147] does not appear to turn the psychological key which is apparently locked in the minds of many by the mention of these magical terms. The fact that both the political left and the political right agree on the importance of these institutions to the country as a whole reinforces the point.[148] Anything that can be shown to impinge in some way on these fundamentals is, for that reason alone, bad and needs to be changed.

And changes there were, both in the capital gains tax itself and in the remaining death taxes. The federal government, for instance, introduced in 1973 an amendment to permit gains taxes assessed at death to be paid in six annual installments—although it should be noted that this treatment was still less generous than that afforded to capital gains realized during life, for which it is possible through the device of "forward averaging" to postpone the full payment of tax for up to 15 years.[149] In addition, a special system was introduced with respect to farms. Basically, this system amounts to a rollover at death if certain farm assets were used by the deceased, his wife, or children and are bequeathed to his children or grandchildren. Quebec introduced a similar system for its capital gains tax in 1973. As noted earlier, the Ontario government also created in 1973 a special death tax regime for farms as well as the option of paying tax in shares rather than cash for family businesses more generally. In addition, Ontario permits installment payments over a six-year period, while Quebec has had a four-year period since 1969, and British Columbia provides for ten installments for both farms and family businesses, as well as permitting a deferral similar to that in the federal act for farm taxes. The most sophisticated of these systems appears to be that in Ontario, which requires, for example, that the annual deferral of 1/25th of the duty otherwise due on farm assets will be continued (until exhausted) as long as these assets continue to be used as such by members of the family. In contrast, the federal rollover does not contain a similar restriction.[150]

Ameliorative measures of this kind could certainly be expanded in scope and nature if there were indeed serious liquidity problems as a result of the deemed realization provision (in combination with death taxes).[151] Yet what has been done to date in Canada in this respect has not, apparently, satisfied many of those who are worried about these problems.[152] Nor have U.S. opponents of deemed realization shown themselves to be easily satisfied by such liquidity-oriented solutions.[153] Indeed, as suggested at several earlier points, it is not clear that anything short of abolition of the taxes at death will ever satisfy some of those who voice such objections. More generally, it may again be suggested that the difficulty in devising politically satisfactory solutions to the liquidity problem in large part reflects the fact that the problems are not really those of liquidity at all, but rather are of a more deep-seated psychological nature. One can on selfish grounds alone explain why the rich do not want to be taxed, for example; but without appeal to some such fundamentally irrational notion as the mystique of the small business yeomanry one cannot easily explain the apparent breadth and depth of the politically potent support which they can so easily arouse on the capital gains and death tax issue.

The other arguments against taxing deemed realizations at death listed at the beginning of this section may be dealt with more briefly since they have, for the most part, not received much attention in the Canadian discussion. The argument that this proposal acts as a deterrent to wealth accumulation and investment has, of course, often come up in the form of the family farm and firm diatribes mentioned above, as well as in a more general "taxing capital" context. The conventional economic rebuttals to this position—"From an economic point of view it is difficult to think of a less efficient way of encouraging savings and risk-taking investment than eliminating the death tax,"[154] for example—have proved to be as unconvincing to the public mind for the most part as have the similar rebuttals of the common notion that the capital gains tax at death and the death tax per se really amount to the same thing. No matter how often it is repeated that taxes cannot directly destroy real capital, the news that some prominent local capitalist is thinking of taking up residence in the Bahamas inevitably brings to mind visions of closed factories and unemployed workers—or at least such seemed to be the case in the Atlantic Provinces, where some well-publicized insinuations along these lines from some prominent local interests appear to have been a major factor leading to the speedy abandonment of the succession duties which had initially been introduced after federal withdrawal from the death tax field.

Somewhat curiously in view of the subsequent actions in Canada with respect to inflation (notably the partial indexing of the personal income tax), there appears to have been no real consideration at any time in the tax reform debate of the alleged compounding of the tax by inflation which has been sometimes offered as an argument against deemed realization in the United States. Similarly, the rather odd notion of "regressivity," in the sense that the actual cost of the gains tax is less to the taxpayer the higher the marginal rate of the death tax to which he is subject, came up only once in Canada, in the

Report of the Ontario Advisory Committee on Succession Duties, where it received only passing mention.[155]

The final point in the list at the head of this section—basis problems—received somewhat more attention, however, as was only natural given that Canada had no previous experience with a capital gains tax of any variety. All in all, the various valuation problems connected with the introduction of capital gains taxation have occupied a good deal of space in the professional journals over the last few years.[156] They also led to an expansion of the valuation section of the Department of National Revenue[157] and resulted in the foundation of a new Canadian Association of Business Valuators. Nevertheless, while it is no doubt true that valuation problems occupy a larger role in the work of professional tax advisers than before the 1971 tax act, there do not appear to have been any special difficulties encountered on this account in implementing either the capital gains tax in general or the deemed realization provisions in particular.[158]

A number of reasons may be suggested for this apparently easy birth where once a long and arduous delivery was expected. In the first place, there appears to be no doubt that the use of an end-1971 valuation day to establish the basis for calculating capital gains and losses facilitated the process, despite the fact that this technique has been characterized by some as cumbersome and inequitable.[159] Inequitable in a way it certainly is; but in practice it seems to have worked fairly well. The Department of National Revenue issued an official list of publicly quoted V-day share prices; private sources have issued a similar (unofficial) manual on building costs. The major areas of difficulty thus are the traditional ones of closely held companies, controlling blocks of shares, and the like. The fact that the valuation problems in these areas are very similar to those long faced in the estate tax, and that the valuers trained in the latter field were now generally available for the capital gains tax, appears to have enabled both the government and the private sector to cope with these problems as well as could be expected, although reportedly the government is taking a tough line on V-day prices (the basis). Finally, although there was a good deal of talk about the increased valuation problems as a result of the tax, it is quite possible that the lighter burden of taxes on many estates after the reform in fact alleviated the pressure in this area, as it did with respect to liquidity.

Whatever the reasons, it appears that the introduction of the deemed realization provisions of the capital gains tax has so far given rise to no serious problems in Canada with respect to either valuation or liquidity, or any of the other arguments customarily made against this measure in the United States. Instead, what in the Canadian experience turned out to be the most important problem in the introduction of deemed realization is that there appears to be an inextricable connection in the popular mind between death taxes and taxes at death. To repeat an earlier point, it is ironic that one of the principal results of successfully introducing a measure long lauded as a necessary component of a truly fair income tax—the taxation of capital gains at death—has come close in Canada to putting an end to one of the oldest and, most economists would say, fairest and economically least harmful forms of taxation—the death tax.

Quantitative Aspects of the Capital Gains Tax

Tables 10 and 11 contain the first publicly available information on the capital gains tax assessed on individuals in Canada. (No information is yet available on corporate gains.) The pattern shown in these data is more or less what was expected on the basis of United States experience and the information available in Canada before the tax was introduced: gains are most important in the upper-income classes and shares are by far the largest source of gains. Incremental taxes attributable to capital gains in 1972 and collected by the federal government may be estimated at $61.1 million (or less than 1 percent of total income taxes assessed in that year).[160] In addition, Quebec, which levies its own income tax, may have collected another $5.5 million, for a national total of $66.6 million in capital gains taxes in 1972.[161] The other nine provinces may be estimated to get $12.4 million as their share of the federal capital gains tax. Of the total capital gains tax collected by Ottawa, some 24 percent was paid by those with incomes over $100,000 compared with only 2 percent of total taxes paid by this group, while 52 percent of the capital gains tax (compared with 9 percent of total taxes) came from the over $40,000 group. It is very clear that gains (and, to a lesser extent, losses) are highly skewed towards the higher range of the income scale.

Table 10

Capital Gains Reported in 1972, by Income Class
(in thousands of dollars)

Income Class	Number of Returns Showing Capital Gains	Returns Showing Capital Gains As Percent of Total Returns	Net Capital Gains Reported	Capital Gains as Percent of Assessed Income
$0-5,000	44,463	0.9%	$ 29,104	0.0%
$5,000-10,000	50,062	1.7	44,670	0.0
$10,000-20,000	79,516	4.9	75,061	0.0
$20,000-50,000	37,994	19.0	95,236	1.7
$50,000-100,000	7,324	34.5	53,895	3.9
$100,000 and over	1,708	46.3	52,631	9.9
Total	230,662	2.2%	$351,897	0.5%

Notes:

In addition, 75,000 returns reported a total capital loss of $162.6 million, of which $26.9 million was allowable in 1972. Total net taxable gain was therefore $149.0 million (50 percent of $351.9 million less $26.9 million).

The assessed income figures include only net taxable gains in assessed income so that the percentages shown in the last figure of the table, which ignore losses and the 50 percent inclusion rule, are overstated in this regard.

Source: National Revenue, Taxation, *1974 Taxation Statistics*.

These figures may also be used as a basis for estimating the yield of the tax levied on deemed realizations at death. The only previously published estimates on this matter (by Kul Bhatia[162]) assumed on the basis of U.S. evidence that half of reported net gains could be attributed to the dead (of whom 55,322 filed income tax returns in 1972). This ratio is certainly too high for Canada in 1972, however, and a more plausible estimate for that year would appear to be in the range of 10-20 percent.

Table 11

Capital Gains Reported in 1972, by Type of Asset
(in millions of dollars)

Type of Asset	Number reporting	Net Gain or Loss
Shares	200,121	$194.8
Real estate	27,604	-21.7
Bonds and other properties	27,425	-6.5
All other[a]	78,534	22.6
Total	305,960[b]	$189.4[c]

a. This category includes personal-use property and listed personal property.

b. This column does not add to this total because some returns showed gains or losses on more than one asset class.

c. As noted in previous table, the net taxable gain is in fact less than this ($149.0 million).

Source: National Revenue, Taxation, ***1974 Taxation Statistics***.

This estimate was constructed as follows. As seen in Table 11, reported net gains on shares in 1972 were $195 million. In previous years, when the value of stocks and shares in Canadian estates was reported, the figure remained amazingly constant over time (an average of $240 million at 1961 prices for the last 11 years). If this figure is adjusted (using the 1963-64 Ontario data cited earlier[163]) to account for the omission of smaller estates and also adjusted to 1972 values by means of the "investor's index" constructed by Statistics Canada, the asset value of shares bequeathed in 1972 may be estimated roughly at $441 million. The gain on these shares was then estimated (on the basis of the same index) at $49 million. A significant fraction of this amount would be exempt from tax, however, because it was left to spouses or spouse trusts. The only Canadian data bearing on this point again come from the Ontario study, which showed that 24 percent of assets were left to spouses in 1963-64, when the spousal exemption was very low. It seems reasonable to assume that a ratio of at least 30 and perhaps as much as 50 percent is more plausible for 1972. On this basis, the deemed realization at death of share gains may be estimated at $24.6 to $34.5 million, or 13 to 18 percent of the net capital gains on shares reported in 1972.

Shares are the only asset group for which this calculation can be made. If, however, the same proportion (say, 15 percent on average) is assumed to apply across the board, the implication is that the total taxes collected on deemed realizations at death may have been around $10 million in total, or $9 million ignoring collections by Quebec, with $2 million going to the other nine provinces.

A final rough calculation may now be made to compare the tax estimated above to be attributable to capital gains deemed at death to the death taxes foregone. One simple way to make this comparison is to regress the national accounts data on death taxes on time and to project this trend to "predict" death tax collections in 1972 and later years. Such a regression on 1956-1971 data was used to construct the following predicted values; the actuals are taken from national accounts and are not the same as those shown in Table 9, for reasons noted earlier:

	"Prediction"	Actual	Difference	Difference as Percent of Prediction
1972	272	231	41	15.2%
1973	282	205	77	27.4
1974, first quarter	72	44	28	39.0

Rough as these figures are, they suggest, as does Table 9, that there has been a significant decline in death taxes since 1971. If these figures are combined with the earlier estimates, it may be roughly estimated that the total revenue loss (or lighter burden on estates) consequent on the tax reform was of the order of $30 million in 1972;[164] it has probably become larger since then, given the depressed state of the stock market. This particular estimate may be quite far off, given the many assumptions underlying it, but it seems incontestable on the face of matters that the immediate effect of the various tax changes which have taken place in Canada since 1971 has been to lighten the tax burden imposed at death, not to increase it. Although the federal government too would have lost on this account in 1972, it can be expected to do better on balance as time goes on and the capital gains tax matures, simply because it now gets to keep a much larger fraction (over 75 percent) of the revenues from deemed realizations at death than it did of the estate tax (25 percent).[165] The provinces, however, seem likely to be permanent losers from the exchange for the same reason. Since the significant withdrawal of the provinces from the death tax field will thus result in a loss in revenue for them on balance, it can probably be explained only in terms of interprovincial competition and the fear of "capital flight," with, as usual, the weaker (the Atlantic provinces) going to the wall first in the absence of the shield formerly provided by the federal estate tax.

V

SUMMARY AND CONCLUSION

This paper outlines the implications for private giving of a number of changes which have taken place in the Canadian tax system in recent years. The most important of these changes are the increase in the income tax limit for charitable deductions, the introduction of a capital gains tax with deemed realization at death or gift, and the closely related changes in federal and provincial death taxes.

By way of background, it is first demonstrated that private philanthropy is much less important—and public sector activity in traditionally philanthropic fields correspondingly much more important—in Canada than in the United States. Although the lesser importance of the subject is faithfully reflected in the miniscule explicit consideration of tax effects on philanthropy which has long characterized Canadian tax policy, the paper explores in detail the various tax developments explicitly affecting philanthropy over the last decade.

On balance, it seems likely that the net impact of the set of tax measures explicitly related to philanthropy which have been enacted in the last few years will be to reduce to some extent the charitable giving of the well-to-do. The reasons for this conclusion are threefold. First, the extension to the 20 percent limit is assumed to afford little if any positive stimulus to giving and to free few, if any, would-be donors from a previously felt inhibition to give beyond the old 10 percent limit. Second, despite some recent moves apparently intended to soften the capital gains treatment of some charitable gifts, such gifts will still generally give rise to tax, where previously they did not. On the other hand, the new system has created an artificial inducement to gifts in kind rather than in cash, although it does not go so far in this direction as is done in the United States. Third, the first point is reinforced with respect to charitable bequests, where the percentage limit seems indeed to be most likely to bite, by the fact that capital gains assessed at death must be paid more quickly than gains assessed on lifetime gifts. Since experience suggests that wealthy donors are more likely to give large amounts at death than during life, and there is apparently little substitutability between bequests and gifts, the harsher treatment of gains deemed realized at death may be expected to act as something of a deterrent to charitable bequests, and hence to giving in general.[166] Even more important in this respect is the reduction in death taxes, and the consequent increase in the "price" of charitable bequests.

The attitudes on public policy towards private philanthropy revealed in the course of the long recent debate on tax reform are also summarized in the paper. While there is no clearly articulated official philosophy on this point—and indeed, official policy seems to be concerned as much with limiting abuses as with anything else—it emerges, interestingly enough, that Canadian policy in this area (as in others) has from the beginning been partly dominated by the image of the United States as leader and competitor.

More important tax determinants of the likely future course of philanthropy in Canada than the few measures explicitly concerned with the subject, however, are the significant changes that have taken place in the capital gains and death tax areas. The remainder of the paper is therefore concerned primarily with a fuller description and preliminary evaluation of these changes and their likely effects on private giving.

Several interesting points emerge from this review. First, there are two important factors which may limit the relevance of the recent Canadian experiences so far as American readers are concerned. One such factor is the overriding importance of the federal-provincial issue in Canadian public finance: unless the reader is aware of the much greater importance of the provinces than of the states, he cannot really grasp exactly what has happened in Canada and why. The second, and not unrelated, factor—since the provincial governments serve to articulate clearly such issues in the Canadian political discussion—is that the introduction of a capital gains tax at death (or gift) has been inextricably related in the Canadian context with the reduction, almost to the point of abolition, of other taxes levied on gratuitous transfers. None of the Canadian academic proponents of taxing capital gains at death as part of an improved income tax appear to have given sufficient weight to the very strong political pressures which quickly emerged to offset this "new" tax by getting rid of the ancient death tax. Although this result may reflect some Canadian peculiarity, it may perhaps also suggest the need for more careful consideration of the political as well as economic implications of such "tax reforms."

Another interesting point is that the precise timing of the introduction of deemed realization at death has also turned out to be significant. Although the stock market was buoyant in 1972, its subsequent doldrums mean that in fact few net taxable gains have in fact been realized in the short period since the introduction of the new law. The structure of the new tax also ensured that there has as yet been surprisingly little difficulty in its implementation. In particular, the complete exemption of interspousal transfers and the fact that only gains since a designated valuation day (at the end of 1971) are counted means that there have apparently been few problems with either valuation or liquidity—the two areas in which the forebodings of difficulty had been greatest. Of course, the concurrent changes in the death tax field also alleviated both problems by freeing valuers on the one hand and by providing liquidity on the other.

Despite this generally favourable situation, it is nevertheless interesting to note that the major amendments since the new law was enacted were in the direction of extending favorable treatment to family farms and small businesses—those perennial sorepoints of Canadian tax policy—and extending the payment period for capital gains taxes deemed at death. There have also been several changes intended to lighten the burden on charitable gifts, particularly gifts-in-kind, thus suggesting that, while this issue received little attention before the reform, the new gains tax was felt to restrict such gifts unduly.

In summary, while very little quantitative information is yet available, it may be concluded that the introduction of a capital gains tax including deemed realization at death and gift has given rise to no great difficulties in Canada. One reason for this is that in fact the tax has as yet probably been applied in relatively few instances (especially because of the interspousal exemption). Another is that the substantial reduction in death taxes has removed one of the main sources from which difficulties might be expected. In fact, on balance there is really no question that the combined effect of these measures in Canada to date has been to favor substantially the well-do-do, rather than to hurt them, as one might have expected. Whether the net result of this part of the Canadian tax reform is judged as an improvement or a deterioration thus depends both on one's predilections and on one's expectations as to the future course of events.

With respect to the effects of the tax reforms on private philanthropy, there is again no quantitative evidence, but our expectations are that on the whole the net effect may have been mildly negative. This expectation is to some extent supported by the amendments since 1971 intended in part to restore the attractiveness of charitable giving. It rests primarily, however, on the fact that the reduction in death and gift taxes has, in effect, raised the "price" of charitable giving to an extent unlikely to be offset by the counterbalancing "income effect" of the larger disposable amounts now available. Charitable bequests are therefore likely to be smaller than before. Since there is no reason to expect corporate giving to be changed, and since that small proportion of individual giving affected by tax considerations has probably also been adversely affected by the capital gains tax, it seems likely that on balance there has been, if anything, a small reduction in total giving as a consequence of the tax reforms of recent years. While it seems improbable on the basis of previous experience that this outcome will give rise to much concern in Canada, the present examination of the relation between taxation and philanthropy does suggest that it may at least be time for a more comprehensive and explicit review of the role of private philanthropy and of the effects of public policy on it, more or less along the lines of that now taking place in the United States.

Footnotes

1. For a review of the tax reform process up to 1972, see M.W. Bucovetsky and R.M. Bird, "Tax Reform in Canada: A Progress Report," *National Tax Journal,* XXV (March 1972) 15-42.

2. Compare, for example, the historic data in R.M. Bird, *The Growth of Government Spending in Canada* (Toronto: Canadian Tax Foundation, 1970), Table 25, p. 266, with the data in R.A. Musgrave and J.M. Culbertson, "The Growth of Public Expenditures in the United States, 1890-1948," *National Tax Journal,* VI (June 1953), Table 1, p. 98.

3. S.M. Lipset, *The First New Nation* (Garden City, N.Y.: Anchor Books, 1967), p. 309.

4. The data on government expenditure by function in Canada come from a different official source, which cannot readily be reconciled with the national accounts data in Table 1. See Bird, op. cit., pp. 227-228, on the differences. The same study (pp. 27-32, 160-167) also documents in detail the rapid rise of government expenditures on social services in the postwar period and offers some reasons for this striking growth.

5. See Marc Lalonde, *A New Perspective on the Health of Canadians* (Ottawa, 1974), p. 27.

6. The data on education come from Statistics Canada, *Canada Year Book 1972,* and other StatCan publications. While 46 percent of the Canadian population was Roman Catholic according to the 1971 census, only 1 percent of school pupils were enrolled in private schools under Roman Catholic control in 1972-73.

7. See David Stager, "Religion, Politics, and School Finance in Canada," Paper presented to International Institute of Public Finance, New York, September 1972.

8. The 1957-66 period has been omitted from Table 2 because it is not possible to separate charitable donations for those years.

9. Statistics Canada, *Urban Family Expenditure 1967,* No. 62-530, is the source of the survey data. In order to make the results of the survey usable for present purposes it was necessary to adjust the "expenditure" concept used there to be roughly comparable to that covered by the national accounts concept of personal expenditure on goods and services. It is of interest to note that total gifts and contributions per family in this survey averaged $204, but—perhaps in illustration of the adage that "charity begins at home"—$52 went to support of relatives and $78 to Christmas gifts and the like. "Pure" charity thus accounted for only about one third of total giving.

10. As Paul McDaniel ("Study of Federal Matching Grants for Charitable Contributions," prepared for the Commission on Private Philanthropy and Public Needs) has noted, one might expect 98 percent of present U.S. itemizers of charitable deductions to shift to the standard deduction if the charitable deduction were the only one. Canada comes close to this situation, although the small size of the standard deduction makes it worthwhile for a substantially larger fraction of the taxpaying populace to itemize.

11. The U.S. figure is based on data in Allan Arlett, *A Canadian Directory to Foundations and Other Granting Agencies,* 3rd ed. (Ottawa: Association of Universities and Colleges of Canada, 1973), p. 30.

12. The U.S. figure comes from *Foundation News* (May-June 1974), p. 5.

13. K. Cheng, J.A.G. Grant, and H.M. Ploeger, *Ontario Estates in 1963-64, A Study prepared for the Ontario Committee on Taxation* (Toronto: Queen's Printer, 1968), hereafter CGP. The procedure used to estimate column (2) in Table 4 was as follows: Column (1) was multiplied by BxF/ExL, where B = total bequests in Ontario in 1963/64 (according to CGP), F = the aggregate net value of Ontario estates in 1963/64, according to federal data (from *Taxation Statistics*), E = exempt property for Ontario in 1963-64, according to federal data, and L = the total net value of Ontario estates with value over $50,000,000 in 1963-64, according to CGP. In principle,

assuming that this fraction is constant throughout the period, this calculation yields an annual estimate of all charitable bequests for all provinces and all sizes of estates.

14. See Cheng, Grant, and Ploeger, op. cit., p. 16.

15. See Arlett, op. cit.; also Allan Arlett, "Canadian Foundations: An Overview," *Foundation News* (May-June 1971), pp. 97-100. The periodical is *The Philanthropist*, established in 1972 and sponsored by the Wills and Trusts Section of the Canadian Bar Association through a recently constituted National Committee on Charitable Organizations.

16. Arlett, *A Canadian Directory to Foundations*, op. cit., p. 26.

17. Ibid, p. 18.

18. Arlett, *Foundation News*, op. cit., p. 98.

19. Arlett, *A Canadian Directory to Foundations*, op. cit., p. 20.

20. The current inflation has reportedly forced many foundations to retrench (*Financial Post*, October 19, 1974, p. C-2). It must of course be remembered that major U.S. foundations such as Ford and Rockefeller have also disbursed significant amounts within Canada.

21. According to Arlett in *Foundation News*, op. cit., pp. 99-100: "A leading fund-raising firm in Canada estimates total Canadian giving for the year 1969 at $550 million or about $28 per capita."

22. The U.S. data are based on Arlett, *A Canadian Directory to Foundations*, op. cit., p. 30.

23. It is worth noting, however, that perhaps 25 percent of what would be "gains" in the U.S. were taxed as "income" in Canada (Bucovetsky and Bird, op. cit., p. 16).

24. Gwyneth McGregor, "Charitable Contributions," *Canadian Tax Journal*, IX (November-December 1961) 448.

25. Quoted in James A. Rendall, "Taxation of Contributors to Charitable Organizations under the Income Tax Act," *1973 Conference Report* (Toronto: Canadian Tax Foundation, 1974), p. 153.

26. *Report of the Royal Commission on Dominion-Provincial Relations* (Ottawa, 1940), II, 161.

27. A similar calculation for 1971 (when the ceiling was 10 percent rather than 20 percent) reveals an identical pattern, although all the ratios are slightly lower.

28. The similar pattern seen in U.S. data is explained in part by Martin Feldstein on the grounds that "low-income individuals who file itemized returns are an unusual group with a disproportionately high fraction of aged persons and those with substantial negative transitory income" ("On the Effects of the Income Tax Treatment of Charitable Contributions: Some Preliminary Results," prepared for the Commission on Private Philanthropy and Public Needs, September 1974, p. 12). For this reason, he omits itemizers with adjusted gross income of less than $4,000 from his analysis. This procedure would not seem nearly as suitable for Canada, where, for example, the estimated contribution ratios are substantially higher than in the U.S. up to $10,000 range, where the standard deduction is much lower, and where a larger fraction of both donations and taxpayers are to be found at the lower end of the scale.

29. As an extension of the comment in the preceding note, what is perhaps most interesting about the Canadian data is thus the very much *lower* contribution ratios found at the upper end of income scale, although the "price" of contributions is comparable or higher. A more detailed analysis of the Canada data along the lines mapped out by Feldstein might prove most illuminating.

30. In 1971, for example, total assessed income amounted to $56 billion compared with only $38 billion in taxable income (Department of National Revenue, *1973 Taxation Statistics*, p. 39).

31. Royal Commission on Taxation, *Report* (Ottawa: Queen's Printer, 1967), III, p. 235. Hereafter cited as Royal Commission, *Report*.

32. Ibid., p. 222.

33. Ibid., p. 224. It should be noted that the "social dues" theory of contributions put forward earlier supports such a floor, as does the point noted below with reference to the standard deduction.

34. The report also recommended that the limit be stated as a percent of income before the deduction of medical and charitable expenses but after the deduction of losses carried forward (p. 239).

35. R.M. Bird, "Equity and Taxes in the Carter Report," *1967 Conference Report* (Toronto: Canadian Tax Foundation, 1968), p. 261.

36. This last change was of course particularly urged by the representatives of these museums. See their testimony in Senate of Canada, *Proceedings of the Standing Senate Committee on Banking, Trade and Commerce, 1969-70*, No. 23, May 12, 1970, pp. 40-197 (hereafter cited as *Senate Proceedings*).

37. *Senate Proceedings*, No. 22, May 7, 1970, pp. 54-55 (James Richardson and Sons), and No. 30, June 4, 1970, p. 241 (Canadian Welfare Council).

38. *Senate Proceedings*, No. 30, June 4, 1970, p. 242. (Since there is no index to these proceedings, which are several thousand pages long, it is quite possible some other references to this point have been missed.)

39. *House of Commons Debates*, 3rd session, 28th Parliament, June 25, 1971, p. 7354. (Since these debates are indexed, none of the few references to the subject are likely to have been missed.)

40. Hon. John N. Turner, Budget Speech, May 8, 1972, *Finance Release*, p. 16. This change was in fact not enacted until 1973 (as section 110 (2.1) of the Income Tax Act) owing to the intervention of an election and other delays.

41. J.A. Langford, "The Tax Reform Bill and the Death of a Taxpayer," *Canadian Tax Journal*, XIX (November-December 1971) 513.

42. E.A. Chater, "Administrative Aspects of the Taxation of Charitable Organizations under the Income Tax Act," *1973 Conference Report*, pp. 176-81. The registration rules are set out in Department of National Revenue, Information Circular No. 73-11, May 14, 1973.

43. It is typical that what is apparently the only Canadian study of the origins of "old wealth" was by an American (Gustavus Myers, *A History of Canadian Wealth*, 1914) and that the first Canadian edition of this book was published in 1972! As noted later, Canadians have never been much exercised about the wealthy.

44. John G. Smith, "Taxation of Charitable Organizations under the Income Tax Act," *1973 Conference Report*, p. 175.

45. Hon. E.J. Benson, Budget Speech, June 18, 1971, *Department of Finance News Release*, p. 7.

46. Chater, op. cit., p. 179.

47. See Rendall, op. cit., p. 155.

48. McGregor, op. cit., p. 449.

49. Royal Commission, *Report*, III, p. 240.

50. Smith, op. cit., p. 162; Rendall, op. cit., p. 155.

51. Royal Commission *Report*, III, pp. 225-226. It should be noted that one Commissioner (Mr. Beauvais) declared himself against deeming capital gains on gifts of appreciated property to universities, museums, etc. (*Report*, I, pp. 55-56).

52. Although no minimum amount was specified in the law, administrative interpretation (see Information Circular 73-11, cited in note 42, supra) has made it clear that "old clothes," etc. will not be allowed as deductible contributions.

53. National Revenue, Taxation, *Tax Reform and You: Capital Gains* (n.d.), p. 40; see also H.O. Spindler, "Gifts and Executives," *1971 Conference Report* (Toronto: Canadian Tax Foundation, 1972), pp. 511-17.

54. Turner, op. cit., p. 16.

55. Standing Senate Committee on Banking, Trade and Commerce, *Report on the White Paper Proposals for Tax Reform Presented to the Senate of Canada* (Ottawa, 1970), p. 61; also *Eighteenth Report of the Standing Committee on Finance, Trade and Economic Affairs Respecting the White Paper on Tax Reform*, House of Commons, Second Session, 28th Parliament (Ottawa, 1970), p. 19 (hereafter cited as *Commons Report*).

56. In addition to the reference in note 36, supra, see the similar testimony in House of Commons Standing Committee on Finance, Trade and Economic Affairs, *Minutes of Proceedings and Evidence*, June 15, 1970, No. 61 (hereafter cited as *Commons Minutes*), and the discussion with the Minister of Finance in ibid., No. 91, Ausut 5, 1970. Mr. Thompson, the opposition M.P. noted earlier for his apparent interest in philanthropy, offered a proposal for deduction at fair market value with no deemed realization and a five-year carry-forward (*House of Commons Debates*, Oct. 18, 1971, p. 8789), but it was apparently never officially put forward as an amendment.

57. This position emerges clearly in the statement of the Director of the Montreal Museum of Fine Arts in *Commons Minutes* No. 60, pp. 62-65. The case of the Hirshhorn collection (now in Washington) was specifically mentioned in this connection (p. 71).

58. *Commons Minutes*, No. 61, p. 131.

59. *Senate Proceedings*, No. 23, p. 40. That the argument is somewhat shortsighted has been suggested by those who argue that the effect of the U.S. provisions have simply been to raise the price of art works (mostly to the benefit of other than their creators). On the other hand, if the Canadian museums have to operate in the same market they get the bad without the "good" unless Canada too has a similar provision.

60. For example, The Canadian Institute o' Chartered Accountants, *Senate Proceedings*, No. 32, June 11, 1970, p. 126, and the spokesman for the Canadian Welfare Council, ibid., No. 30, p. 67.

61. Turner, op. cit., p. 16. To be eligible for this option the "tangible capital property" involved must "reasonably be regarded as being suitable for use by the donee directly in the course of carrying on its charitable, public service or similar activities" (Income Tax Act, Sec. 110 (2.2)).

62. The discussion in this paragraph is largely based on Harry Mansfield, "Charitable Contributions of Appreciated Property," paper prepared for the Commission on Private Philanthropy and Public Needs, pages 2254-55.

63. See Richard B. Covey, "Estate and Gift Taxation—Canadian and U.S. Systems and Proposals for Change," *Proceedings of National Tax Association—Tax Institute of America 1973* (Columbus, Ohio, 1974), p. 176.

64. This is the advice given in Sheldon Silver and Stanley Taube, "Estate Planning in Canada," *Canadian Tax Journal*, XXII (September-October 1974) 473.

65. Royal Commission *Report*, III, p. 225.

66. Sheldon Silver and Stanley Taube, "Estate Planning in Canada," XXII *Canadian Tax Journal* (July-August 1974), p. 395. According to the Ontario Advisory Committee on Succession Duties, *Report* (Toronto, 1973), p. 97, the practice of charitable remainders is in fact already a common tax avoidance device in Canada.

67. See, for example, Wolfe D. Goodman, "Transactions in Reversionary Interests," *Canadian Tax Journal*, XXI (May-June 1973): 251-257. A recent book suggests that when the new rules become more widely known, ". . . we will undoubtedly see the National Archives deluged with the private papers of cabinet ministers and civil servants" (Donald J. Johnston, *Fiscalamity: How to Survive Canada's Tax Chaos* (Don Mills, Ontario: Paperjacks, 1974), p. 70). Shades of the Nixon tax returns!

68. This paragraph is based largely on Maurice Cullity, "Charitable Exemptions and Succession Duty," *1973 Conference Report*, pp. 182-189. See also Canadian Tax Foundation, *Provincial and Municipal Finances 1973* (Toronto, 1973), p. 88.

69. The Atlantic provinces, which have now vacated the succession duty field, had an exemption similar to that in Saskatchewan (see Wolfe D. Goodman, *The New Provincial Succession Duty System* (Toronto: Canadian Tax Foundation, 1972), pp. 32-33).

70. Cullity, op. cit., p. 187.

71. Ontario Committee on Taxation, *Report* (Toronto: Queen's Printer, 1967), III, pp. 174-176.

72. On the federal act, see W. Ivan Linton, *A Review of the Estate Tax Act, 1961 Edition* (Toronto: Canadian Tax Foundation, 1961), pp. 10-11. This act limited the exemption to bequests to organizations in Canada and also required an independent determination of whether the beneficiary was indeed "an organization constituted exclusively for charitable purposes."

73. Advisory Committee, *Report*, p. 97.

74. Ibid., pp. 28-31; the quoted phrases are on p. 28.

75. For example, by an M.P. (Mr. Kaplan) during the Commons Committee Hearings as a "phony private museum" which is "really nothing more than a tax gimmick" (*Commons Minutes*, No. 61, June 15, 1970, p. 68).

76. See notes 36 and 56, supra, and also the brief of the University of British Columbia, in *Commons Minutes*, No. 85, July 29, 1970.

77. From a report cited in *The Philanthropist*, I, No. 2 (Fall 1973).

78. From testimony by a representative of the Canadian Welfare Council in *Senate Proceedings*, No. 30, p. 66.

79. Spindler, op. cit., p. 511.

80. Quoted by Cullity, op. cit., pp. 188-89.

81. *House of Commons Debates*, February 9, 1957, p. 977.

82. Lipset, op. cit., p. 287. See also note 43, supra.

83. On Canadian social myth and reality, see also John Porter, *The Vertical Mosaic: An Analysis of Social Class and Power in Canada* (Toronto: University of Toronto Press, 1965).

84. Royal Commission *Report*, III, Chapter 15.

85. See Bucovetsky and Bird, op. cit., p. 30.

86. E.J. Benson, *Proposals for Tax Reform* (Ottawa, 1969), p. 42. There were also a number of other changes in the form of capital gains tax proposed: see Bucovetsky and Bird, op. cit., p. 19. The present discussion deliberately oversimplifies a very complicated discussion.

87. See especially Joseph B. Katchen, "Deemed Realization: A Proposal," *Canadian Tax Journal*, XVIII (July-August 1970) 342-366.

88. The *Senate Proceedings*, for example, offer a number of examples: James Richardson and Sons Ltd. (No. 22, May 7, 1970, pp. 68-69), Board of Trade Metorpolitan Toronto (No. 35, June 18, 1970, p. 122), Trust Companies Association of Canada (No. 37, June 24, 1970, pp. 110-111), Canadian Institute of Chartered Accountants (No. 32, June 11, 1970, p. 103), Canadian Bar Association (No. 34, June 17, 1970, p. 86). It is of interest to note a somewhat similar position has been taken by The American Banker's Association (see Covey, op. cit., pp. 160-194).

89. R.D. Brown, "Problems in the Timing and Measurement of Capital Gains," *1970 Tax Conference* (Toronto: Canadian Tax Foundation, 1971), p. 74.

90. The next few paragraphs follow closely Bucovetsky and Bird, op. cit., pp. 23-24.

91. Subsequently, a special six-year payment period for gains taxes levied at death was introduced, as had been suggested by the Commons Committee (and had existed for some years in the federal estate tax).

92. Brown, op. cit., p. 74.

93. J. Harvey Perry, *Taxation in Canada*, 3rd ed. (Toronto: University of Toronto Press, 1961), pp. 183-185.

94. The various changs which took place in these arrangements over the post-war period are described in A.M. Moore, J.H. Perry, and D.I. Beach, *The Financing of Canadian Federation* (Toronto: Canadian Tax Foundation, 1966).

95. *Canadian Tax Journal*, XI (March-April 1963) 87.

96. *Canadian Tax Journal*, XII (May-June 1964) 150-151.

97. Royal Commission, *Report*, Vol. III, Chapter 17.

98. *Canadian Tax Journal*, XVII (March-April 1969) 164.

99. E.J. Benson, *The Taxing Powers and the Constitution of Canada* (Ottawa, 1969), pp. 30-36.

100. Ibid., p. 34.

101. E.J. Benson, *Summary of 1971 Tax Reform Legislation* (Ottawa, 1971), p. 33.

102. Statement by Parliamentary Secretary to Minister of Finance, *House of Commons Debates*, (October 19, 1971), p. 8851.

103. For a good example of this reaction, see Bucovetsky and Bird, op. cit., pp. 37-38; see also George E. Carter, "Federal Abandonment of The Estate Tax: The Intergovernmental Fiscal Dimension," *Canadian Tax Journal*, XXI (May-June 1973) 239.

104. Mr. Beauvais, in Royal Commission, *Report*, I, p. 62.

105. *Report of The Royal Commission on Dominion-Provincial Relations*, II, p. 160. It is of interest to note that the later attitude expressed by Ontario (see below) could be put more or less the other way, that is, "successions are best taxed through capital gains taxes."

106. This line of argument may be found in different forms in *House of Commons Debates*, February 26, 1971, p. 3803 (Mr. Thompson); Charles MacNaughton, in *Ontario Proposals for Tax*

Reform in Canada (Toronto: Department of Treasury and Economics, 1970), p. 29; Commons Minutes, No. 79 (Professional Art Dealers Association), p. 138, and Ontario Advisory Committee on Succession Duties, *Report*, p. 14.

107. Benson, *Taxing Powers*, op. cit., p. 34.

108. Wolfe D. Goodman, *The New Provincial Succession Duty System* (Toronto: Canadian Tax Foundation, 1972), p. 1.

109. Mr. Simard, New Brunswick Minister of Finance, *Hansard*, 1972, p. 18.

110. Even though, as has been noted, the basis of the new successions duties made avoidance of the tax possible only if the heirs moved too (see John Bossons, "The Effect of Income Tax Reform on Estate Taxes in Canada," *Proceedings of National Tax Association 1973*, p. 150).

111. For references to the "tax haven" problem, see the report of the 8th meeting of the Council of Maritime Premiers in *Canadian News Facts*, December 1-15, 1972, p. 933, and the exchange between an opposition member and the provincial Minister of Finance in Nova Scotia, House of Assembly, *Debates and Proceedings*, February 23, 1973, p. 936. (Incidentally, Prince Edward Island, Canada's smallest province estimated that total collections from the new death tax over the three years would amount to only $240,000!)

112. Information taken from various publications of the Canadian Tax Foundation, especially the "Check List" which appears in the bimonthly *Canadian Tax Journal*.

113. Cited in Graham Goldstein, ed., *Readings in Death and Gift Taxation* (Mineola, N.Y.: Foundation Press, 1971), p. 160.

114. For a well-taken critique of the Royal Commission on this point, see Gerald R. Jantscher, "Proposal to Tax Gifts and Bequests as Income to the Recipient," *1967 Conference Report*, pp. 417-423.

115. Martin David, however, has recognized the connection, noting that "if the present income and transfer taxes achieve a satisfactory balance, the increased income taxation associated with the presumptive realization of gains at gift or death would have to be offset by reduced transfer taxation" (*Alternative Approaches to Capital Gains Taxation* (Washington, D.C.: The Brookings Institution, 1968), pp. 161-162). Elsewhere David refers to the "psychological barriers to increased taxes assessed at death" (p. 163). Canadian experience lends strong weight to the views along these lines which he attributes primarily to "investment counsellors and lawyers" (p. 163n.), suggesting, perhaps, that such groups are much more important in the tax reform process than economists like to think.

116. See R.M. Bird, "The Tax Kaleidoscope: Perspectives on Tax Reform in Canada," *Canadian Tax Journal*, XVIII (September-October 1970) 458.

117. Brown, op. cit., p. 73, attributes this expression to the Minister of Finance, Mr. Benson. For a similar, if less colourful, statement by Mr. Benson, see *Budget Speech*, June 18, 1971, p. 13.

118. D. Allen Grumbine, "Alternative Gains Tax Treatments of Decedents' Appreciated Capital Assets," *Vanderbilt Law Review*, XXVII (April 1974) 519.

119. National Revenue, *1973 Taxation Statistics*, p. 204.

120. Ontario Committee on Taxation, *Report*, III, pp. 134-136.

121. An earlier instance may be found in *Report of the Royal Commission on Dominion Provincial Relations*, II, pp. 119, 157.

122. Ontario Committee on Taxation, *Report*, III, p. 207. No mention was made of the danger of a return to the "tax jungle" of the 1930s, although this may have been what one reviewer of the *Report* had in mind when he drew the opposite conclusion, namely, that Ontario should get out

of the field and leave it to the federal government. See Michael Jameson, "Death and Gift Taxes," *Canadian Tax Journal*, XV (November-December 1967) 543.

123. *1969 Ontario Budget* (Toronto, 1969), p. 58.

124. *1970 Ontario Budget* (Toronto, 1970), p. 29.

125. Charles MacNaughton, *Ontario Proposals for Tax Reform in Canada* (Toronto, 1970), p. 29.

126. *1971 Ontario Budget* (Toronto, 1971) p. 27.

127. Darcy McKeough, *The Reconstruction of Economic and Fiscal Policy in Canada* (Toronto, 1971), p. 25.

128. Darcy McKeough, *Introduction to Supplementary Estimates and Tax Legislation* (Toronto, 1971), p. 27.

129. *1972 Ontario Budget* (Toronto, 1972), p. 37. A new gift tax was introduced, however.

130. Advisory Committee on Succession Duties, *Report* (Toronto, 1973), p. V. For a similar position, see Covey, p. 163.

131. Ibid., pp. 10-11.

132. *Commons Report*, p. 34.

133. Advisory Committee, *Report*, p. 14.

134. Appendix C found that only 4 percent (10) of the farms and 10 percent (12) of the family controlled businesses included in the dutiable estates in 1970 and 1971 were reportedly sold to pay taxes. It is also noteworthy that less than 600 of the 10,000 estates taxed in those two years reported such assets. *In no case were these sales to foreign owners.*

135. For another striking example of the truth of this proposition, see J.K. Savage and D. Van den Bulcke, *Transfer Taxes: Their Effect on Productivity and Control of Our Economy* (Toronto: Ontario Economic Council, 1968). Even William E. Crawford, "Payment of Death Duties," *1973 Conference Report*, pp. 244-254, who recognizes on p. 244 that capital gains and death taxes are quite different taxes and on p. 246 that there are very few real liquidity problems and that these can be alleviated in several ways, proceeds to spend the bulk of his paper talking about this terrible problem.

136. *1973 Ontario Budget* (Toronto, 1973), p. 29.

137. Since this Foundation is a Crown agency, bequests to it are presumably also not subject to the 20 percent deduction limit under the income tax.

138. *1974 Ontario Budget* (Toronto, 1974), p. 12.

139. Grumbine, op. cit., pp. 505-514.

140. Ibid., p. 505.

141. Benson, *Taxing Powers*, op. cit., p. 34.

142. Grumbine, op. cit., p. 508.

143. *Commons Report*, p. 32.

144. For a lengthy exposition of the relevant provincial and federal rules with respect to farms, see C.D.F. Skerrett, "Interspousal Transfers and Family Farm Transfers," *1973 Conference Report*, pp. 260-301.

145. As noted above (note 135) the 1973 paper by Crawford is particularly interesting in this regard because he shows much more awareness of the arguments going the other way than do most authors. He even cites, for example, one of the few efforts to explicitly demythologize the family-firm issue (see R.M. Bird, "The Case for Taxing Personal Wealth," *1971 Conference Report*, pp. 20-41). Yet somehow he is able simply to ignore both argument and evidence and discuss at length the "liquidity problems occasioned by the combined effect of death duties and tax on deemed capital gains" (the subtitle of his paper). Other commentators took the easier route of simply ignoring any fact or opinion contrary to their own.

146. See, for example, the references to the papers by Kurtz and Surrey and Waterbury in Grumbine, op. cit., pp. 507-510.

147. See Bird, *1971 Conference Report*, pp. 20-21.

148. On the left, see "Minority Report of the Members of the New Democratic Party on The House of Commons Standing Committee on Finance, Trade, and Economic Affairs Regarding the White Paper on Taxation," October 5, 1970, which advoated taxation of capital gains at full rates and treating gifts and bequests as income but nevertheless wanted specially favourable rules for family farms. (Traditionally, the Western farmers provide one of the strongest supports for the NDP (socialist) party.) On the right, see the brief of Alberta in *Commons Minutes*, No. 92, pp. 45, 62, 94-96, which argued that the combined effect of capital gains and estate taxes was confiscatory and would destroy family farm units.

149. This point is made by Crawford, op. cit., p. 247. See also R.E. McKay, "Forward Averaging," *Canadian Tax Journal*, XXI (March-April 1973) 134-143, for an outline of this system, which permits the postponement of taxation on certain kinds of income (including capital gains) through the purchase of an income-averaging annuity contract. Vladimir Salyzyn, *Income Averaging and Canadian Tax Reform* (Don Mills, Ontario: CCH Canadian Ltd., 1971), describes the new averaging system as a whole.

150. On these various provisions, see Crawford, pp. 251-252. The same author (p. 253) characterizes the Ontario provision for share payment (which appears to have been based on the British experience with EDITH) as probably unworkable.

151. For one interesting suggestion along these lines, see John Bossons, "The Impact of Tax Rates on The Effect of Tax Reform," *1970 Conference Report*, pp. 26-27, where a system of automatic loans (at an interest rate higher than the government borrowing rate) was suggested to alleviate any liquidity problems arising from deemed realization.

152. See, for example, John M. Fuke, "Post-Mortem Estate Planning," *1972 Conference Report*, p. 267, who complains that at an interest rate tied to the yield on government bonds, the installment scheme is no bargain.

153. Grumbine, op. cit., pp. 509-512, reviews the reaons usually advanced to show the inadequacy of such solutions.

154. John Bossons, "Economic Overview of the Tax Reform Legislation," *1971 Conference Report*, p. 55. See also Bird, *1971 Conference Report*, pp. 16-19, for an attack on the "deterrent" view.

155. Advisory Committee, *Report*, p. 7.

156. See, in particular, Canadian Institute of Chartered Accountants, *Solving the Valuation Problem* (Toronto, 1972) (a reprinted series of articles from the *Canadian Chartered Accountant*); also George Ovens, "Preliminary Notes on Canadian Price and Value Problems Resulting from Tax Reforms," *Canadian Tax Journal*, XIX (September-October 1971) 401-409, and Graham W. Wright, "Fair Market Value and Security Valuations under The Tax Reform Bill," *Canadian Tax Journal*, XIX (November-December 1971) 500-507.

157. Ten regional offices were established, compared with the previous three (A.M. Allan, "Tax Reform and Valuation for Capital Gains," *1972 Conference Report*, pp. 407-493; also Department of National Revenue, Taxation, Information Circular No. 72-25, September 12, 1972).

158. This assessment is based on communication with the Canadian Association of Business Valuators as well as on discussion with other tax practitioners.

159. David, op. cit., pp. 149-150.

160. This amount has been calculated by applying the appropriate marginal tax rate for the average taxable income for each class to the net taxable capital gains for each income class.

161. The calculation for Quebec is derived by applying Quebec marginal rates and assuming that the proportion of net gains taxed in each class is the same proportion that total gains taxed to Quebec residents by the federal government is to total gains.

162. Kul B. Bhatia, "Estimation and Taxation of Capital Gains in Canada," *1971 Conference Report*, pp. 91-103.

163. See note 13, supra.

164. This figure should strictly be reduced further, say, to $22 million, to allow for the fact that Alberta and (previously) Saskatchewan refunded the death taxes collected on their behalf to the estate.

165. Bossons, "Economic Overview," op. cit., pp. 55-57.

166. While there appears to be almost no relevant research on the substitutability of lifetime for death time transfers, the observed reluctance of most wealthy people to avoid death tax by gifting suggests that there is something to the argument in the text. See Carl S. Shoup, *Federal Estate and Gift Taxes* (Washington, D.C.: The Brookings Institution, 1966), pp. 21-25, on some possible reasons for the lack of lifetime giving. See also the interesting argument attributed to one of the wealthiest Canadians of recent times in the quotation at note 81 supra.

THE SYSTEM FOR REGULATION AND ASSISTANCE OF CHARITY IN ENGLAND AND WALES, WITH RECOMMENDATIONS ON THE ESTABLISHMENT OF A NATIONAL COMMISSION ON PHILANTHROPY IN THE UNITED STATES

Donald R. Spuehler[†]

Introduction

The 1972 Ditchley Conference

In 1972 the Council on Foundations sponsored a discussion at Ditchley Park near Oxford, England, on the general subject of charity, or philanthropy, and its proper role in fulfilling societal needs. The results of the conference were published by the council in "Philanthropy in the Seventies: An Anglo-American Discussion" (1973). (Summary papers on the English and U.S. systems of charity were prepared by Christopher P. Hill, First Chief Charities Commissioner under the 1960 Reconstituted Charity Commission, and F. Emerson Andrews, President Emeritus of The Foundation Center. Also included in the published report were summaries of the debates and comments on the conference by Harry V. Hodson, for the British, and John J. Corson, for the United States.)

Perhaps more important than the published material on the Ditchley Conference was the strong feeling carried back to the United States by those responsible for directing charitable efforts that certain aspects of British treatment of charity might be applied in some form in the United States for the general benefit of charities and the public. In hearings before the Subcommittee on Foundations of the Senate Committee on Finance in October 1973, Alan Pifer, President of Carnegie Corporation of New York (which helped to finance the Ditchley Conference), testified as to the need for some sort of supervisory center, sympathetic to the needs of charity and the public, which would have the following principal functions: (1) power to determine charitable status; (2) maintenance of a central register of charities, with listings in the register being a guarantee of tax-exempt, charitable status; (3) conducting audits of charities; (4) assuring that legal standards applying to charities were enforced; (5) issuing advisory opinions on legal consequences of proposed actions by charitable organizations; (6) periodic gathering and publication of information on activities and assets of charitable organizations; (7) advising Congress and the executive branch on charitable matters.

As amplified by Marion Fremont-Smith in the 1973 hearings, the functions of such a supervisory body as spelled out by Alan Pifer are part of a structure with "striking similarities to the English system." Ms. Fremont-Smith pointed out that this was no accident but rather a result of those testifying before Congress having attended the Ditchley Conference and their further thoughts on the possibility of adopting some parts of the English system in the U.S. In fact, the creation of a National Commission on Philanthropy recommended by Sheldon Cohen, another Ditchley participant, as an organization independent of the Treasury Department and any other existing organization appears to be modeled on one particular part of the English system, the Charity Commission.

[†] O'Melveny & Myers, Los Angeles.

This paper is designed to stimulate further thought as to the desirability and potential scope of a national commission on philanthropy or equivalent organization. It is based on a number of interviews with representatives of the Charity Commission, the Inland Revenue Service, solicitors, and others interested in the charitable area in England and on discussions with the man on the street, conducted during a sabbatical year spent in London.

A Summary Description of English Practice and Assistance of Charities

The assistance function is taken quite seriously in the English system and is perhaps the greatest cause of envy of the British system by U.S. charities, which feel that most of the emphasis in this country is on regulation with little attention given to assistance.

An understanding of the English charitable landscape is almost impossible without an historical perspective. This paper is not aimed at a scholarly analysis of the history. Two of the best works in this area are W. K. Jordan, *Philanthropy in England 1480-1660* (New York, 1959) and David Owen, *English Philanthropy 1660-1960* (Cambridge, 1964). Two standard works on the legal aspects of this area are Tudor on Charities, sixth edition (London 1967) and Keeton and Sheridan, *The Modern Law of Charities*, second edition (Belfast, 1971).

As has been pointed out by most commentators, until the late nineteenth century the English government depended upon private charitable initiative to bear the chief responsibility for social improvement, with the state assuming an interstitial role in the development of what we would consider modern social welfare services. This is true of welfare payments to the poor, establishment of hospitals, development of education, and almost all other fields in the area of social welfare. The mark of history on English charities is of more than academic interest. The strict view of the Charity Commission and English courts generally as to the scope of *cy pres* may be traced to gifts in medieval times made more for the benefit of the soul of the donor in purgatory than for the specific purposes of the church or relief of the poor. Under this general philosophy, the "dead hand" of the donor could be expected to be, was, and is respected in a way that seems restrictive in modern-day circumstances. A substantial portion of the work carried on by the Charity Commission consists of making modern sense out of gifts and bequests made in trust some two or three centuries ago. And the present English system for regulation and assistance of charities and pressure for reform of the system, which continues to date, cannot be understood without considering past history in this area.

With the rise of towns in the sixteenth century, the dissolution of the monasteries, the distribution of the lands of the rich by Henry VIII, and a host of other economic and political factors, the existence of poverty as a national problem was recognized in the Poor Relief Act of 1601 which allowed local authorities to levy a compulsory property tax for the relief of poverty. The Statute of Charitable Uses, enacted in the same year, constitutes the starting point of the modern law of charities.

The process begun by the Statute of Charitable Uses was twofold. First, it was felt necessary to establish a system for reforming abuses in the administration of property contributed for charitable purposes. A system was set up for the appointment of ad hoc commissioners to inquire into allegations of negligence, maladministration, and diversion of charitable funds to non-charitable objects. Second, the preamble to the Statute of Charitable Uses, still the basis for the definition of charitable purposes, set out a wide variety of purposes that were deemed charitable; the list was not intended to be exhaustive but to serve as a guide to stimulate donors in devoting their resources to improvement of social conditions.

The regulatory and reformatory aspect of the system set up by the Statute of Charitable Uses eventually proved to be an unwieldy method of controlling charitable administration. By the early nineteenth century, it was generally suspected and confirmed that there was substantial maladministration in the charitable area. In 1818 Parliament set up a commission under Henry Brougham which was limited to an investigation and recordation of all charitable trusts for the education of the poor in England and Wales. In the 19 years during which the Brougham Commission functioned numerous cases calling for reform were discovered (the costs of the inquiry were in excess of 200,000 Pounds Sterling, a staggering amount at that time). Perhaps more important, the commission inquiry established the variety of existing charitable trusts and suggested to the Select Committee which reviewed its findings that some system of systematic control should be established. Although the report of the Select Committee on the need for systematic supervision of charities was published in 1835, influential and strong resistance of some of the most important charities to any control prevented a statute from being enacted until 1853.

The Charitable Trust Act of 1853 and its amending act of 1855 established the first Charity Commission. The commission was not subordinated to any government department. Two of the three commissioners were full-time professional and salaried appointments, the third member normally being a member of Parliament who acted as the commission's representative in answering parliamentary questions on charities and in introducing bills promoted by the commissioners.

The 1853 Charity Commission had wide powers of investigation and inquiry. To put into perspective the modern Charity Commission, established by the Charities Act of 1960, it is useful to consider the powers of the original commission. Under the 1853 legislation and other miscellaneous acts promulgated through 1939, the Charity Commission had the following powers:

1. The commission could give advice upon the application of the trustees or others concerned in administration of the charitable trust; the trustee could rely on advice given, an indemnity essentially being given to those who acted upon an opinion of the commissioners.

2. Upon application by trustees or others, the Charity Commission could control dealings with the property of trusts, control legal proceedings by trustees, and act with respect to compromise of claims.

3. The commission could investigate administration of charities, requiring accounts and other information and taking further action through the courts or attorney general that appeared proper.

4. The commission had power to appoint or remove trustees or officers and could make schemes within the limits of the *cy pres* doctrine as applied by the courts, subject to appeal to the Chancery Division.

How did the original Charity Commission system perform in practice? By admission of the commission itself and on analysis by the Nathan Committee, whose report was the precursor of the 1960 Charities Act, the answer has to be that it did not work very well.

For example, under the Charitable Trust Amendment Act of 1855 an obligation was imposed upon all charitable trustees not specifically exempted to submit accounts annually to the Charity Commission. A striking illustration of the kind of problem existing was that "less than a third of the trusts known to the Commissioners submitted their accounts, due partly to the ignorance of some trustees about their obligation, partly to shortage of staff in the Charity Commission itself, but principally because the absence of any specific penalty for failure to submit them seems to suggest that the obligation was not regarded very seriously."[1] A major problem was that of staffing, exacerbated by the absence of any cabinet officer to represent the interests of the Charity Commission before Parliament. In 1860, with responsibility for about 32,500 trusts, the commission had a staff of approximately 50, with the legal staff numbering 25. In 1950, with an estimated 80,000 charitable trusts under its jurisdiction, the commission staff had grown to 125 but the legal staff had shrunk to about 20. The 1950 legal staff consisted of two commissioners (excluding the Parliamentary commissioner), eight people in the position of chief clerk, principal clerk, or senior legal assistant, and ten other clerks or legal assistants.[2] Given the limited staffing, it is no surprise that the pre-1960 Charity Commission acted almost entirely by responding to requests of trustees or, in rare cases, acting when some specific problem in the charitable area attracted public notice. Many suggestions for amending the charities law were recommended by the commissioners, but with no contacts with Parliament except through the back-bencher who worked as Parliamentary commissioner, few of the commissioners' suggestions bore fruit in legislation. As the Nathan Committee noted, since the last major legislation had occurred in 1869 the commissioners may well have simply despaired of making changes in the structure of their relations with government.

Finally, a very narrow construction of the doctrine of *cy pres* in the courts limited the ability of the Charity Commission to make "schemes," in English parlance, for the application of the funds of ancient trusts for purposes more consistent with modern charitable theory. The typical problem in this area is that of a trust for distribution of bread or flannel petticoats or other payments in-kind to the poor inhabitants of a local parish. While admitting the outmoded nature of this sort of gift, the courts tended to remain adamantly tied to the principle that the expressed intention of the original donor must prevail.

The following section examines the extent to which the completely revised Charities Act of 1960 and the reestablished Charity Commission corrected the defects of the system that existed prior to 1960. At this point it is enough to note that the present Charity Commission must be seen as a successor in function to the original commission and to previous efforts aimed at encouraging charity and imposing some sort of control over potential abuses.

The commission continues primarily as a public body charged with assuring that charitable trustees act in accordance with their trusts. The commission also acts in many ways, formally or informally, as a government-paid advisor to trustees and, in connection with the official custodian function, as a means for providing free managerial services to charity. A major change made by the 1960 act is that the Charity Commission is the final arbiter, within its jurisdiction, as to the charitable status of organizations for all purposes. Under section 5 of the 1960 act, "an institution shall for all purposes other than rectification of the register, be conclusively presumed to be or have been a charity at any time when it is or was on the register of charities."

The effect of Charity Commission registration as creating a conclusive presumption "for all purposes" extends to the area of taxation. In particular, charities are, by virtue of their status, relieved from 50 percent of property taxes otherwise payable. The local authority may at its discretion allow up to an additional 50 percent relief from such taxes.

In the income tax area, registration of the charity potentially exempts the registered organization from all income taxes including capital gains taxes. To actually be entitled to [illegible] tax exemption, the charity must not have "trading income," analogous to unrelated trade or business income under the Internal Revenue Code, and the Inland Revenue must be satisfied that all funds going to the charity are in fact expended for charitable purposes.

To greatly oversimplify the relation between the Charity Commission and Inland Revenue, it can be said that the commission is primarily interested in an "organizational test" of whether an entity is organized for exclusively charitable purposes, while Inland Revenue is more concerned with an "operational test" of whether, for tax purposes, the activities and expenditures of the charity are such that tax exemption is justified. In the case of a trustee who acts outside the scope of his trust, the Charity Commission can institute proceedings to surcharge the trustee individually for amounts misspent. The sanction of Inland Revenue for noncharitable activities is the denial of tax exemption on all or part of the charity's receipts.

Except in egregious cases, the Charity Commission is not directly involved with control over methods of solicitation employed by charities. House-to-house collections and street collections are generally within the police power exercised at the cabinet level by the Secretary of State for Home Affairs. Certain national collections are authorized on a national basis by the Home Office. Other local collections would be authorized upon application to the local police authority. General regulations are approved by the Home Office in the same way as for collection box placement and regulation. Curiously, except for very general fraud prevention legislation, no direct control is exercised over mail solicitations. When discussing this with charities and the regulators, the rationale given was that no regulation was necessary since such solicitations are basically ineffective.

I

THE CHARITY COMMISSION UNDER THE CHARITIES ACT OF 1960

General Structure

The Charity Commission, under its three commissioners, has a staff of approximately 350 and a budget of over 1,000,000 Pounds Sterling a year. Under general government decentralization procedures, approximately one third of the total staff is located in Liverpool. For the most part, national charities are handled out of the London office, with the Liverpool office carrying on registration and advisory functions with respect to Northern England. Since the Chief Inspector of Taxes (Charity) and his staff of 180 are located in Liverpool, the small Accounts Scrutiny Section of the Charity Commission is also located there.

Of the three charity commissioners, two are required to be barristers or solicitors. Interestingly, the position of Chief Charity Commissioner has, to date, been held by the non-lawyer member of the commission. The first Chief Commissioner was Christopher P. Hill, assigned to the Charity Commission from the Home Office to draft what eventually became the 1960 Charities Act. The present Chief Commissioner, T.C. Green, assumed the position upon Hill's retirement in 1965.

To appreciate Hill's effort in drafting the Charities Act of 1960 one need only note that there have been no amendments to the act and no call for amendments. This is somewhat astounding in that all of the substantive law directly applicable to charities and their definition is contained in the act and that all prior legislation, involving some 200 enactments including those with respect to mortmain, were repealed or amended by the 1960 act. In addition, the annual reports of the pre-1960 commissioners, which had largely become mere statistical reports, were turned by Hill into relevant descriptions of the commission's general work with detailed analysis of problems facing the commission.

The following description of the operation of the Charity Commission is organized according to the functions carried out within the commission's different departments. Snce compulsory registration was a major change instituted by the 1960 act and carries with it the conclusive presumption of charitable status, this area of commission work is examined first. Other advisory and assistance functions are then outlined, along with consideration of relevant provisions of the Charities Act.

Registration

When the 1960 Charities Act was passed, concurrent jurisdiction was given to the Charity Commission and the Secretary of State for Education and Science for certain kinds of charities. Educational charities of all types were administered by the latter, a situation that created certain conflicts within the office of the Secretary itself. For example, as administrator of educational institutions, the office might be pressing for a change in the educational or charitable purposes of an organization, and as administrator under the Charities Act, it would be required to judge whether changed purposes were permissible. The Education Act of 1973 terminated the powers of the Secretary of State for Education and Science under the Charities Act, giving the Charity Commission sole jurisdiction.

As of December 31, 1973, 94,501 charities were listed on the central register maintained by the Charity Commission. To increase the usefulness of the central register, 10 regional registers have been established for national charities and numerous registers with local authorities are maintained which list local charities of particular interest to donors and donees in the locality. In addition, certain veteran and disabled-person charities must register with the local authority in which their head office is located, as well as with the Charity Commission, primarily for control of solicitation practices.

Registration of Existing Charities

At the time the Charities Act was being considered by Parliament, it was estimated that there might be some 150,000 charities to be registered under section 4 of the act. Section 4 requires charity trustees of any charity to apply for registration unless they are excepted by the act or by regulation of the Charity Commission. In early reports, the commission expressed its hope that registration of existing charities would proceed at the rate of something like 30,000 a year. In fact, because of difficulty in communicating the registration requirement to trustees, the number registered per year reached a peak of 16,400 in 1964 with about 15,000 charities being registered in 1962 and 1963. Considerable ingenuity was exercised by the Charity Commission staff in contacting organizations required to register who had not done so. For example, the Brougham reports of the early nineteenth century were examined to locate parochial charities existing at that time; these were then pursued with the help of the National Council of Social Service and local authorities. Considerable difficulties were encountered with the registration of smaller charities whose trust documents may have been lost or misplaced or, in many circumstances, where older trusts were established orally.

The registration card prepared for each charity lists the name, governing instruments, objects, geographical area benefited, income, Inland Revenue reference number if applicable, person in charge, and various geographical identification material. Three indexes are maintained in the central London Office, one on a geographical basis, another alphabetically, and the third filed in accordance with the purposes of the charity. In addition, cards are prepared for local authorities to be kept in a local index and additional copies of slips for national charities are held at the 10 regional centers. Typical of the practical problems involved, the Charity Commission has made it clear that existing organizations "which had been accepted as being charitable were in fact registered without too close a scrutiny of their objects."[3] In essence, a more stringent standard is applied to new charities seeking registration for the first time simply because Parliamentary sentiment during debate of the 1960 act was that organizations that had long been treated as charities for tax and other purposes should be sympathetically treated when applying for registration.

With respect to statutory provisions, it should be pointed out that although charity trustees are required to register, the only initial penalty for non-registration is that the trustee "may be required by order of the Commissioners to make good that default." In an extreme case, the commissioners can report a refusal to register to the Attorney General; but consistent with a low-key, persuasive approach in asserting its powers under the 1960 act, the commission has not resorted to this type of pressure.

Registration requirements, and other aspects of the 1960 act as to powers of the Charity Commission, do not extend to all charities. The second schedule to the 1960 act lists a number of organizations that are exempt from registration and regulation: universities exempted by order of the Queen (all universities are, in fact, exempted); the British Museum; certain employee benefit and Friendly Societies. The commission also has power to except certain charities by order or regulation. This has been done in the case of organizations like the boy scouts and girl scouts, most voluntary schools, and a large number of religious charities. Finally, all charities that do not have a permanent endowment, income from property amounting to more than 15 Pounds Sterling a year, or the use and occupation of any land are exempt. This would except a large number of collecting charities which merely gather funds (not considered as income in the sense of the statute) and disburse them to other charities. The substance of exceptions contained in the act or in orders or regulations is that charities that are already adequately supervised — that is, religious funds supervised by a central church authority and de minimis charitable activities — are relieved of the registration requirements. One useful aspect of registration, however, is that it establishes under section 5 of the act the conclusive presumption of charitable status. Section 4 allows an otherwise exempt organization to register in order to claim the benefits of a registration number and the publicity which indexing may afford.

Registration of New Charities

Of some surprise to the Charity Commission has been the large number of newly formed charities seeking registration—some 1,000 to 1,500 a year. The process followed in registration is worthy of some detailed examination, not only because it illustrates many of the attitudes expressed in other commission actions, but because it is the focus for contact between the commission and Inland Revenue

The Registration Division of the commission has approximately 42 in staff in London and 15 in Liverpool. (Although its functions are quasi-judicial, the division is headed by a person who is neither a barrister nor solicitor, which apparently poses no problems.) To understand the registration process, it is necessary to consider how an organization is classified as charitable or noncharitable. Section 46 of the 1960 act provides that "charitable purposes means purposes which are exclusively charitable according to the law of England and Wales." To an American lawyer accustomed to the Internal Revenue Code, Regulations, Revenue Rulings, letter rulings, and the rest, this simple and naive definition of charity solely be reference to judicial decisions seems just short of incredible. However, that is in fact the way charity is defined in England. From discussions with senior staff on the Board of Commissioners of Inland Revenue, we learned that this present system is no different from the one applied by Inland Revenue prior to 1960 and still applied by it with respect to charities that are not required to be registered with the Charity Commission.

Mention has already been made of the preamble to the Statute of Charitable Uses of 1601 which has been the touchstone of charitable definition in the myriad court cases in English law. The catechism most often used by lawyers working in the area and by Inland Revenue and the Charity Commission is the summary on charitable purposes announced by Lord Macnaghten in *Commissioners for Special Purposes of the Income Tax v. Pemsel,* A.C. 531, 583 (1891). In his presentation, Macnaghten categorized "charity" as relief of poverty, advancement of education, advancement of religion, and other purposes beneficial to the community not falling under any of the preceding. In the hearings leading to the Nathan Report, it was suggested by many that a statutory definition of charity should be attempted. The final decision of the Nathan Committee was that a statutory definition should be attempted, but in the course of Parliamentary debate no attempt was successful and the case law prevailed, a decision the Charity Commission found comfortable enough to work with. In its 1973 annual report the commission states that "we believe that any statutory definition of charity would be likely to raise as many problems as it might solve."[4]

In an extensive discussion of its attitude toward defining "charity," the commission stated as its general position that it was simply exercising the kind of power that would be exercised by a court in interpreting prior court decisions and, directly or by analogy, applying those decisions to the case before the commission.[5] The commission stated, "it is our hope that by constant attention to previous court decisions, we shall succeed in developing from them, with the approval of the court if there is an appeal, such a concept of the field of charity as may meet the needs of the community."

As might be expected with judicial precedent being the only reference point for defining what is charitable, the scope of purposes recognized as charitable in England is not the same as that in the U.S. Since "the relief of aged" is specifically mentioned in the preamble to the 1601 Statute of Charitable Uses, an organization established with that purpose is by definition charitable, without there being any showing of poverty or need on behalf of the aged being maintained. Since the courts have held, under an 1895 decision, that fostering of an attitude of mind cannot be a valid charitable purpose, the United Nations Association is not exempt in England and the "promotion of international understanding" is not a charitable purpose. On the same grounds, an organization established to prevent discrimination will not be exempt, but an organization "to promote good citizenship in a multi-racial society" will be granted charitable status. While personnel of the commission's Registration Division admit some lack of logic in the rules, their actual application of the rules is the application which would be made by a court tied to judicial precedent.

Summarizing the registration objectives, the commission has stated, "our primary concern under the Act is to see that the purposes of an organization as set out in its governing instrument are charitable in law, and we are not entitled to look much beyond that unless we have some reason to doubt whether the organization genuinely intends to pursue a course of activity that lies within those purposes on a reasonable construction of the words used."[6] The commission takes the position that as long as a charity meets certain basic requirements, it cannot be refused registration. Thus, for example, registration will not be refused an organization even though its name is similar to or the same as that of another registered charity.

To illustrate the registration process, let us assume that a group wishes to establish an organization for some charitable purpose. The first contact of the group with the Registration Division may be an informal one, to solicit information on the governing instrument of like organizations which are closest to their purposes and which have been approved by the Charity Commission. Governing instruments are public documents; under section 9(2) of the act specifically authorizing supply of copies, the commission has a standard charge per page for duplicating and sending exemplars to potential applicants.

Usually the next step for the new charity is the presentation to the Registration Division of a draft copy of its governing instrument together with any additional information that the applicant thinks might be helpful to the commission. Normally, the governing instrument will be a trust. Although use of the Companies Act is becoming more frequent, England has no general nonprofit corporation law equivalent to that found in most of our states, and application of corporate doctrines designed for profit companies can be awkward in the charitable area.

There is no required form for application to the Charity Commission. If the objective of the charity is specific, for example, "aid of the blind through provision of transportation services as required by the Foundation for the Blind," the trust itself may be the only document necessary for registration. If purposes are more general—"aid of the blind"—the Registration Division will normally request additional information on the specific means to be used by the charity in fulfilling its objectives. After the governing instrument and any other required information are received, the Registration Division prepares a memorandum on any potential problems with the registration or, in complex cases, sends the information to a solicitor in the Legal Department of the commission for additional comments. The comments of the Charity Commission are sent, along with applicable documents, to the Chief Inspector of Taxes (Charity) in Liverpool for review. Relevant Inland Revenue and Charity Commission comments are then discussed with the applicant. In transmitting comments to the applicant, the Charity Commission tends to discount any remarks of the Inland Revenue that are believed to relate to administrative problems within Inland Revenue rather than to proper definition of the applicant as a charity.

In rare cases, Inland Revenue in Liverpool may disagree with the commission that the applicant is qualified as a charity. If the Registration Division is, upon review, still of the view that the applicant is a legitimate charity, a review within the Inland Revenue is initiated. If the Chief Inspector continues to feel that noncharitable status should be recommended, the file is forwarded to the Board of Commissioners of Inland Revenue in London; if the board's staff agrees with the noncharitable status finding, a further review is initiated in the board to consider whether the importance in precedential value or money justifies further argument with the Charity Commission. In the event it is decided that protest is justified, a formal memorandum of dissent from proposed registration is sent to the commission and considered by the commissioners.

Since many charitable applicants find they are able to yield to negative Inland Revenue comments without basically affecting their future operations and since the process of review within Inland Revenue winnows out many initial objections, these formal memoranda of Inland Revenue to the Charity Commissioners are rare. The exact numbers are not known, but the Chief Commissioner and the Assistant Secretary of the Board of Inland Revenue Commissioners both agreed that the number of such memoranda would have been less than 12 in the first 13 years of operation of the 1960 act. This does not mean, however, that differences do not exist. Under its general power to challenge registration in the courts, Inland Revenue has notified the commission that it plans to request from the court deregistration of two charities in the "promotion of sports" area.

Accounts

Section 8 of the 1960 act requires that statements of account "shall be transmitted to the Commissioners by the charity trustees on request; and, in the case of a charity having a permanent endowment, such a statement relating to the permanent endowment shall be transmitted yearly without any request, unless the charity is excepted by order or regulations."

If the visitor to the London offices of the Charity Commission picks out a file of index cards at random, it quickly becomes apparent that a large number of cards are incomplete. Many have no Inland Revenue reference number and a great number have no information on annual income. It was pointed out that one of the failings of the pre-1960 Charity Commission was the lack of power to enforce the annual account requirement. This defect still exists: under section 8(6) of the act the remedy for failure to transmit any statement of account is that "the Commissioners may by order give to that person or to the charity trustees for the time being such directions as the Commissioners think appropriate for securing that the default is made good." Of course, resort can be had to the Attorney General and courts, but this procedure is awkward, considered too onerous, and has not been used except in connection with the institution of inquiries under egregious circumstances. The question as to what percent of charities had complied with the annual accounts requirement was met by commissioners and commission staff with embarrassed silence. "Not for the record" guesses by the staff would indicate that between 40 percent and 50 percent of registered charities required to submit accounts are in default.

The lack of zeal in pursuing charities that do not file accounts can be explained by a number of factors: shortage of staff in the initial registration process; added pressure on staff as a result of transfer of functions from the Department of Education; a general feeling that, on the basis of the scrutiny of accounts to date, abuses do not exist; and, perhaps most important, a practical approach by the commission to the charitable population they administer.

One of the few published statistical summaries of the charitable population administered by the commission is found in the commission's 1970 annual report. An analysis of annual income of charities for which information was available showed that 85 percent had an annual income of less than 250 Pounds Sterling. Twenty-three percent of all charities had a yearly income below 5 Pounds Sterling; 11 percent had an income between 5 and 10 Pounds Sterling. Only 3 percent of registered charities had annual incomes in excess of 10,000 Pounds Sterling.

The distribution of charities by yearly income fits with the historical development of charities set out above. There are an immense number of parochial charities, administered by the reverend of the local parish or by citizens of the community, whose resources are small and with respect to which the commission has little reason to suspect abuse of the trust position.

In 1966 an accounts scrutiny procedure was established, and it is clear from commission reports that a large number of trustees had to be reminded of their duty to submit accounts. (The commission found it encouraging, however, that in only about 15 percent of account request cases was a second reminder necessary.) In 1967, in connection with the move of personnel to Liverpool, accounts scrutiny was discontinued. The findings on accounts that had been examined were that no cases of fraud or dishonesty had been discovered, that some funds had been expended for purposes not strictly authorized, and that some helpful advice might be given to trustees still providing Christmas doles and investing in 2.5 or 3.5 percent government consols. In its 1973 annual report, the commission noted that a small Accounts Scrutiny Section had been established in Liverpool. During 1973 the accounts of approximately 8,500 charities were examined. Again, no major abuses were found, although in some cases payments had been made for purposes not covered by the trusts and the perennial problem of uneconomically small distributions and poor investments still existed.

The commission does not take its supervisory position lightly. All major charities with substantial assets and income report on an annual basis and are reviewed by one of the five Charities Divisions of the commission assigned to charities by charitable purposes or geographical location. In addition, new charities and charities with broad powers in operation or in the making of grants are requested to or automatically file annually.

Drawing attention to the "assistance" function of the commission, it might be noted that commission reports indicate that Accounts Scrutiny did reveal the use of funds for non-trust purposes. An example is a typical parochial charity for local community purposes that makes a contribution to the local football team. If the expenditure came to the attention of the Inland Revenue, some tax liability might result. Commission staff were quite clear that their responsibility in the case of such an expenditure was to warn the trustees as to their mistake, but that this responsibility did not extend under the Cooperation with Inland Revenue provisions of section 9 of the 1960 act to furnishing information discovered to Inland Revenue. The attitude of the commission is that any such action would have a serious "chilling effect" on trustee-commission relations.

The Official Custodian for Charities

The 1960 act created the Office of Official Custodian for Charities, replacing the Official Trustee of Charity Lands and the Official Trustee of Charity Funds established under pre-1960 acts. The position of the Official Custodian is that of a holder of bare title only. The actual management and control of property transferred remains with the charity trustees. All expenses of the Official Custodian are defrayed by the commission.

Approximately 60 people staff the Office of the Official Custodian. The advantages for charity of the work of this office are threefold. First, management and administrative work which would otherwise fall to charity staff are carried on by the Official Custodian's staff. Second—and this is important because the preferred form of charity in England is the trust—property can be vested in the Official Custodian avoiding the necessity for periodical transfers of land and security upon appointment of new trustees. Finally, through informal arrangements with Inland Revenue, the Official Custodian can remit dividends and interest to the charity without deduction of U.K. tax.

The need for the Custodian is attested to by the roughly 50,000 charity accounts that he maintains and by the amount of funds, nearly 200,000,000 Pounds Sterling in 1973, held by him.

The use of the Custodian to avoid management expense and transfers with change of trustees are both obvious, but further explanation is necessary with respect to the tax benefits attributable to security and bondholding by the Custodian.

A keystone of the present British income tax system is the satisfaction of most income tax liability by withholding. In the earned income area, P.A.Y.E. (Pay-As-You-Earn) withholding provisions are similar to their U.S. equivalents. But unlike the American system (except in the foreign area), payors of most of the periodic payments, including dividends and interest, are required to withhold at the so-called "basic rate" of approximately 30 percent. If a charity receives dividends, it must file with Inland Revenue to recover tax withheld. Ordinarily, the charity may not receive this reclaimed tax for a period of anywhere from six months to two years. The Official Custodian, strictly by grace of successive Chief Inspectors, shortcircuits the ordinary reclamation process. As dividends are received, showing tax withheld, the Custodian "tops up" his dividend account by requesting from Inland Revenue funds equal to the amount of tax withheld. Dividends received, grossed up to include tax withheld, are thus remitted almost immediately to charities, increasing the cash flow of the charity and voiding the necessity for separate application by the charities to Inland Revenue. At the end of each government fiscal year, the Official Custodian and Inland Revenue make adjustments to keep accounts current. However, since in the view of the Custodian and the commission the point of the exercise is to save administrative work for Inland Revenue and since all property held by the Custodian belongs to charities registered with the commission, Inland Revenue has no contact with individual charities through their application for reclamation of tax. Since, as amplified below, Inland Revenue may never have its attention drawn to a charity except through a request for reclamation of tax, the Custodian system constitutes a political barrier to Inland Revenue's examination and review of the use of funds by charities.

As indicated above, the Official Custodian holds only bare legal title to charity assets and is not legally responsible for administration of assets held. Despite this formal structure, the Custodian's office is often the focus for requests from trustees for investment advice. While not officially responsible for such advice, the Custodian and his staff regularly refer charity trustees to investment advisors or, in some cases, counsel them as to better investment choices. In this connection, the Custodian's staff examines the governing instrument of each charity for which it holds an account. If a request is made for capital distributions where the trust does not allow capital distributions, the Custodian will point this out to the trustees.

As part of the general charity recommendations of the Nathan Report, though not embodied in the Charities Act of 1960, restrictions on charity trustee investments have been greatly liberalized by the Trustee Investments Act of 1961. Prior to that act, charity trustees were restricted for the most part to government stocks and certain other first-class securities providing fixed income and having a fixed redemption value. After the Trustee Investment Act charities were allowed to invest up to one half of trust property in a wide range of industrial and commercial ordinary shares, the other half to be invested in a somewhat expanded list of "gilt securities." The Official Custodian is often asked by charity trustees to check compliance with the 1961 act.

The Nathan Committee deliberations resulted in section 22 of the 1960 Charities Act which allows the court or commission to establish common investment funds for participating charities. The first such fund was set up by the commission to serve almshouse charities and at the end of 1970 had assets worth approximately 3,500,000 Pounds Sterling. In January 1963 the Charities Official Investment Fund was established for the investment of assets of charities generally. Investments in the fund may be made by charities only through the Official Custodian.

The Charities Official Investment Fund has independent trustees and is profesionally managed, expenses being charged against earnings. The Charity Commission has general powers of supervision and the right to discharge trustees, but in practice, meetings of trustees of the fund and commission are advisory and informational in nature. Pursuant to section 22(9) of the 1960 act, the Charities Official Investment Fund is itself a charity and registered as such with the commission. Under an arrangement premised on the same administrative convenience that characterizes relations between the Official Custodian and Inland Revenue, the fund recovers income tax withheld on a monthly basis so that income is appropriated to participating charities on an almost immediate gross basis. Despite generally bad performance of the stock market in the United Kingdom, distributions of income amounting to a yield of 6.85 percent on the cost of a share in the pool as of January 1, 1974, were realized during 1973.

The Consents Division

Under the 1960 act, there are a number of actions that may not be taken by charity trustees without the specific consent or order of the Charity Commission. It is the function of the staff of approximately 40 in the Consents Division to supply necessary approval under the statute.

Section 29 of the 1960 act contains a flat prohibition against certain dealings in charity property without the specific order of the commission. In the areas covered by the act, unauthorized action by charity trustees will, with few exceptions, be held void. Under section 29, approval of the commission is required for any mortgaging of property forming part of the permanent endowment of the charity and for the sale, lease, or other disposition of land in England or Wales that is part of the permanent endowment. Some protection is given bona fide purchasers of so-called functional land—land used or occupied by the charity at present or in the past. Aside from this narrow exception, which applies to land where the purchaser may not by inspection or investigation be able to determine the facts with respect to property, exceptions are also made for transfers permitted by other acts of Parliament, for leases of not more than 22 years' duration, and for transfers specifically excepted by order of the commission.

The reason given for imposing restrictions on sale of land, which do not exist with respect to sale of securities, is the difficulty of evaluating real estate and the often radical change in charity purpose which is the result of a sale of land.

Since a purchaser of land covered by section 29 of the act cannot receive good title without a commission order, charity trustees are forced to come to the commission with any prospective offer. Very often, according to Charity Division staff, a charity may first come to the attention of the commission upon its application for an order to sell land. In such cases, where the charity has not regularly filed accounts with the commission or is not on the register, defaults in accounting are first corrected. Then, unless the commission is satisfied that the proposed sale has been made after solicitation of competitive bids, the charity is instructed by the commission to publish notices advertising the price offered and inviting higher offers. The substitution of commission judgment for charity judgement with regard to sale of charity land has been the subject of some criticism. However, in its 1970 annual report the commission noted the conclusion of the Nathan Committee that watchdog status in this area was necessary and justified its procedures on the pragmatic ground that "higher offers for property received during 1970 resulted in an increase in the selling price varying in general between 5% and 25%, but in one case property for which the original offer was 28,500 Pounds Sterling was sold for 38,650 Pounds Sterling."[7]

Certain transactions of branches of religious bodies are excepted from the provisions of section 29. Other exceptions are given on specific transactions or to specific charities where land held represents the proceeds of income which may be spent for general purposes of the charity.

Many older charities are often funded by rent charges, payable in perpetuity by the fee owner of the land. In the course of multiple transfers of land, the rent-charge obligation is often lost sight of. Moreover, since the charge is most often a fixed sum, the dependability of the income is minimal and actual receipts small. Under section 27 of the 1960 act, a general procedure for redemption of rent charges is provided, and where such charges come to the attention of the commission, the commission works with the charity through order or necessary consents to have rent charges redeemed.

When establishing "schemes" under the 1860 amendment to the 1853 act, the commissioners very often imposed an obligation on charities to notify the commission as to appointment of trustees, the appointment being made conditional upon commission approval. After more than 100 years' experience, this safeguard against charities being controlled by unsuitable persons has been judged unnecessary. When requests for approval of appointments are made to the commission or when the commission makes "schemes" for charities limited by the old appointment rules, an invitation is issued to the trustees to request abolishment of the notification requirement. This is part of the routine function of the Consents Division.

Two other miscellaneous areas are handled by the Consents Division. First, it gives advice on certain aspects of charity administration, in particular, matters pertaining to salaries, pensions, and other payments to officers and employees of the charity. The division also responds to requests for information about a charity, except where the matter can be more appropriately handled in the General Charities Divisions.

Local Review

In 1883 Parliament provided in the Parochial Charities Act for the establishment of the City Parochial Foundation under the general jurisdiction of the

Charity Commission. A confused mass of parochial charities existed in the London area. Their services were restricted to the population of parishes and often involved expenditure of most income on doles or payments in kind. The Charity Commission was authorized under the 1883 act to classify the various operating charities and to place the assets of moribund charities in a central foundation for the benefit of education and other charitable purposes throughout the London area. The City Parochial Foundation was a great success, building capital to roughly 4,500,000 Pounds Sterling by the early 1900s and substantially benefiting educational and other organizations in the London area.

An example of Parliamentary bending of the judicial *cy pres* doctrine is found in the Endowed Schools Acts, 1869 to 1948. These acts empowered the schools covered to bring about a better geographical distribution of existing endowments in the educational area by allowing transfers of schools or endowments to parts of the country having insufficient facilities. Broad scheme-making powers were granted independent commissioners whose decisions were clearly made on the basis of economic factors outside the terms of trusts establishing the various endowments.

The City Parochial Foundation and Endowed Schools Acts were clearly in the minds of the Nathan Committee in its consideration of the charitable landscape in England in the 1950s. There were numerous examples of ancient trusts for the provision of doles, and in the context of the welfare state, many trusts found themselves with outmoded purposes—purposes that were being largely satisfied by government departments.

The Nathan Committee recommended that local authorities be given the right to take the initiative in applying for schemes for local trusts in their territory. This was rejected by the Government in its White Paper which was the predecessor to the 1960 act. Instead, sections 10, 11, and 12 provide for a cooperative effort on the part of local authorities and local charities. Section 10 allows the maintenance in any county or borough of an index of local charities, the index to be supplied by the Charity Commission free of charge, and further allows the local authority to appoint a local voluntary organization as its agent to maintain and publicize the index. Section 12 of the act provides generally for cooperation of charities and local authorities in satisfying the needs of the community and authorizes charities, notwithstanding anything in their trusts, to make appropriate expenditures for cooperation in local review of charitable activities, for coordination of charitable activities, and for publication of information about other charities.

Section 11 permits the local authority to initiate reviews of the operations of any group of local charities with the same or similar purposes and to make recommendations on ways of coordinating activities of these charities to the Charity Commission. However, section 11(3) provides that "no review initiated by a council under this section shall extend to any charity without the consent of the charity trustees, nor to any ecclesiastical charity."

The commission has stressed the fact that cooperation of both the local authority and the charity trustees is necessary for local review to be effective. The local review section of the Charity Commission, through its contact with local authorities and its encouragement of the review process, has attempted, within the trustee consent provisions, to make section 11 of the act meaningful. Six hundred seventy schemes for combination or change of local charities were established through 1973. The commission emphasizes the benefit of local reviews even where no combination of assets of trusts results. The commission often finds new registrants through local meetings and hopes that these meetings make charity trustees more aware of their obligations in investment, reporting, and other areas.

Despite the number of schemes resulting from local reviews and the generally optimistic reports of the commission, it is apparent that the local review program has not been a great success—if success is measured by more efficient marshalling of local parish charitable assets. In its 1968 annual report the commission reports a general pattern of parochial charities being unwilling to combine forces.[8] The individual charities are afraid of losing their separate identities and consider it their duty to the donor to preserve gifts in the donor's name. Charities, often with income of less than 5 Pounds Sterling to distribute each year, insist that their yearly distributions are a tradition of the locality. Those charities whose sole purpose is to distribute the equivalent of $1.00 apiece to 20 of the local poor or to distribute bread, blankets, or flannel petticoats argue that local beneficiaries have become accustomed to receiving these gifts. Another major part of the problem is the social status attached to the position of trustee of a parochial trust and the feared loss of status when merging with a larger group of trustees. It must be concluded that efficiency in use of charitable assets has not been substantially furthered by local review under the 1960 act.

General Supervision and Assistance

The specific functions of the Charity Commission required by the Charities Act, which are outlined above, occupy approximately half of the commission's staff of 350. The remainder of the staff is concentrated in five charities divisions, assisted by a legal consultant division and a drafting section. The divisions are divided by geographic jurisdictional responsibility or by function with respect to national charities, educational charities, war charities, and so forth. The five charities divisions carry out the broader purposes entrusted to the Charity Commission under the 1960 act.

Before describing the responsibilities of the charities divisions, it is useful to set out the general goals established for the commission in sections 1(3) and 1(4) of the 1960 act.

> § 1(3) The Commissioners shall (without prejudice to their specific powers and duties under other enactments) have the general function of promoting the effective use of charitable resources by encouraging the development of better methods of administration, by giving charity trustees information or advice on any matter affecting the charity and by investigating and checking abuses.
>
> § 1(4) It shall be the general object of the Commissioners so to act in the case of any charity (unless it is a matter of altering its purposes) as best to promote and make effective the work of the charity in meeting the needs designated by its trusts; but the Commissioners shall not themselves have power to act in the administration of a charity.

General Functions

In general, the charities divisions see their role as one of encouragement without control. Registration of charities under the 1960 act has been much more successful than under the 1853 act, since registration provides the benefit of proof of tax exemption and ability to state to the public that the organization is a "registered charity." From the Charity Commission's standpoint, its registered charities are constituents whose best interests are to be served by the commission.

In 1974 a Commission for Study of Charities was set up under the chairmanship of Lord Goodman. The criticisms of the Charity Commission which led to Lord Goodman's study are reportedly that the commission (1) has applied the 1960 act to outmoded charities and under rules set up by the Statute of Charitable Uses, 1601, has been to cautious and avoided innovation and (2) has not been aggressive in using its powers under the 1960 act to force amalgamation of small charities, which have become more and more ineffective as inflation has reduced the value of their endowments.[9]

The work of the charities divisions can be broken down into four major areas: (1) advice of trustees, (2) application of *cy pres* and the making of schemes, (3) inquiry and audit of charities, and (4) general supervision and assistance. It should be pointed out that the charities divisions will also be involved in work of the commission's other divisions when important changes occur with respect to charities allocated to those divisions. For example, where land that forms part of the endowment of a charity has greatly appreciated and the charity applies for sale of the land, the charity division may step in to review whether the funds generated by the sale will be effectively used within the terms of the charity's trust instrument. Or with respect to registration of local branches of a national charity, the charities division may work with the registration division and the national charity in establishing a model trust for use by the local charity.

Advice to trustees. Under section 24 of the 1960 act the commissioners may advise a charity trustee or give their opinion on any matter affecting the performance of the trustee's duties. Unless there has been a misstatement of material fact and until a decision of the court has been obtained that supersedes the opinion or advice given, the charity trustee is considered by law to be acting in accordance with his trust. A great number of requests for advice, most of which are standard, are handled by the charities divisions. Requests may involve, for example, questions as to how broadly a "relief of the poor" clause in a trust can be interpreted, that is, which persons in the local community are to be defined as poor. In many cases, there may be no written trust instrument, which is allowable under British law, although there is a fairly clear understanding of what the endowment fund was meant to cover. In these cases, particularly, the parish minister or local trustee may want to obtain the insurance policy of written advice from the commission.

Application of cy pres and the making of schemes. Section 18 of the 1960 act gives the commission concurrent jurisdiction with the court in establishing schemes for the administration of a charity (essentially, restructuring the trusts under which the charity operates so as to adapt it to specific problems facing the charity), in appointing or removing a charity trustee, and in dealing with the property of a charity. The 1960 act gives the court the power to refer such matters to the commission.

In general, the commissioners are not to exercise their powers under section 18 of the act except on the application of the charity or where the matter is referred to the commission by a court. For those charities with an income of less than 50 Pounds Sterling a year, jurisdiction may be exercised by the commission on application to the Attorney General by one or more of the charity trustees, by any person interested in the charity, or by two or more inhabitants of the local area in which the charity operates (section 18(5)). Section 18(6) provides that where the commission believes the charity trustees ought to apply for a scheme and they have "unreasonably refused and neglected to do so" the commission may on its own motion proceed with scheme-making (after appropriate hearings have been afforded the charity trustees). This power of the commission is limited to charities that are more than 40 years old.

The commission has never used its powers under section 18(6), contending that to do so would jeopardize the amicable relations between the commission and charity trustees which are essential to the effectiveness of the commission's work.

Inquiry and audit of charities. The accounts that charities are required to submit to the commission are unaudited. Where there has been a complaint as to operation or administration of a charity, the commission has broad powers to institute inquiries under section 6 of the 1960 act. The commission has powers to take testimony, to order an audit by a recognized body of accountants, and to obtain information from the charity. In the commission's first ten years of operation, there were only seven formal inquiries under the section 6 provisions. Only one of these inquiries resulted in formal action to replace trustees and to place the charity under commission control as provided for in section 20 of the act. The small number of formal proceedings does not mean that the inquiry and audit powers of the commission are ineffective. As pointed out by the commission in its 1970 annual report, its practice is to use informal inquiry and discussion with trustees in attempting to bring about desired changes, without the publicity attendant to formal inquiry proceedings. Examples given by the commission are problems faced by charities which have overextended themselves financially or, at the other extreme, charities whose trustees concentrate on maintaining a surplus to the detriment of the objects that the trust is to perform. The general approach of the commission is best illustrated in this quote from their own analysis of procedure:

> Some complaints can be dealt with simply by sending a copy of the complaint, with the writer's consent, to the charity in question for the trustees' comments or by asking the trustees for information required to clarify the situation. In most other cases discussion with the trustees has been sufficient to set the administration on the right path and it has not been necessary even to suggest the possibility of a formal inquiry.[10]

General supervision and assistance. One criticism of the Charity Commission under the 1853 act was that it had little communication with its charitable constituents except those in the City of London, who had ready access to commission offices. The reconstituted commission has actively worked to inform all charities of what it can do for charity trustees.

Soon after passage of the 1960 act, the commission issued a number of informational leaflets to charity trustees. The annual reports have outlined the work of the commission and indicated the generally friendly attitude of the commission toward charities. Some information bulletins have been sent to charities with respect to certain problem areas such as political activities and the need for trustees to be aware of strict self-dealing rules which prohibit their receiving any salary or selling or renting property to the trust.

With the rudimentary state of accounts scrutiny and analysis, the commission has not to date been an effective body in collection and publication of statistical information on charities. Much more information is available from publications of the National Council of Social Services or the Charities Aid Fund, described in some detail below.

Aid in Interaction with Government— The Almshouse Example

A favorite seventeenth-century charity in England was the almshouse, a self-contained apartment or house for the care of the aged in a community.

Typically, a structure was left in the control of the local council or parish together with an endowment for maintenance and for payments of pensions to the inhabitants of the almshouse.

The period after World War II was one of crisis for many almshouses, which might be picturesque and important architectural monuments but are without plumbing and other amenities considered necessary in the twentieth century. As part of the attempt to make maximum use of the various almshouse charities around Britain, and to coordinate their improvement within the concept of the welfare state, the National Association of Almshouses was formed in 1951 as an outgrowth of the London Association.

The Charity Commission, as reconstituted by the Charities Act of 1960, focused on the subject of almshouses in its 1960 annual report. The commission found in working with the National Association of Almshouses that the trust instruments of many of the almshouses were out of step with changed conditions: Small endowments had been eaten away by inflation and by required investment in low-interest government bonds; many trust instruments required that there be no charge to the almshouse inhabitants; various restrictions existed on sales of property in mid-city locations when it was clear that cheaper land for construction of new facilities could be found out of the city if valuable land in the city could be sold and the proceeds used for that purpose.

The welfare state brought with it numerous new grant programs applicable to the aged and poor, and the commission saw as its duty to get the maximum benefit of these tax-paid programs for the particular charities involved. Improvement grants were available from the government to put in amenities such as inside plumbing and cooking facilities. Many trusts were restructured by the commission so that the almshouse could take maximum advantage of these grant programs. As part of the National Assistance Act, local authorities were authorized to contribute to the voluntary organizations providing care for the aged, and the commission again restructured the governing instruments of almshouses to take maximum advantage of this form of aid. Finally, direct pensions to the aged were available from the National Government. With some fine mathematical balancing, almshouse trustees were authorized not only to cut down pensions provided from almshouse trust funds, but to make charges for almshouse occupancy. This resulted in release of funds for repairs or amortization of debt, with the almshouse inhabitant being no worse off since charges to him or reduction of his pension from the voluntary association were replaced by national grants.

A specific case reported in the 1965 annual report illustrates the commission's work in this area. A Somerset almshouse charity, whose structures were over 250 years old, had received a notice under the Housing Act, 1957, which would have required demolition or closing down of the facility. The charity's endowment was clearly inadequate to undertake the necessary repairs. Modernization was accomplished by means of an Extraordinary Repair Fund of the National Association of Almshouses, national assistance grants, and a loan from the rural district council secured by a mortgage on the charitable property. A new scheme for management of the almshouse included the "usual clause enabling the trustees to obtain contributions from inmates towards maintenance and essential services." Within two years, an antiquated structure had been brought up to modern standards by taking full advantage of benefits available under the welfare state.

Another example is the Esther Doe Memorial Almshouse established by a charity founded in 1868. After attempts at modernization through expansion of powers of the charity in 1963, the charity trustees had encountered problems in establishing a modernization scheme that could be financed with available funds and that would provide temporary accommodations for the then occupants of the 12 almshouses involved. The trustees informed the commission in 1971 that a builder had been found who was prepared to construct modern almshouses on the charity's land in exchange for a conveyance to him of the real property for commercial development of part of the property. The commission, under its supervisory powers with respect to transfer of land, made a finding that the value of the new houses to be provided to charity would be 65,000 Pounds Sterling whereas the value of the land conveyed would be 60,000 Pounds Sterling. The developer had also agreed to schedule building so that occupants could continue to occupy the old structure until new accommodations were available. The commission approved a general scheme for transfer of the property and restructuring (including charges to inhabitants) operation of the charity, providing accommodation for "poor spinsters of good character who are not less than 55 years of age and of the Protestant faith, preference being given to persons who were born in Bethnal Green, Whitechapel or Streatham."

Modernization–Outmoded Purposes

In 1768 the Magdalen Hospital Act established a hospital in Southwark for the reception, maintenance, and employment of penitent prostitutes. This was a popular cause at the time. In the nineteenth century, the corporation established by the act had sold the first hospital and acquired a new structure, which in the 1930s was used as a "senior approved school" for girls under the Children and Young Persons Act (1933). The nineteenth-century structure became unsuitable for this use and after the building was closed, the Charity Commission authorized sale of the property for 250,000 Pounds Sterling. Under procedures set forth in the 1960 Charities Act, the commission established a scheme (which was laid before Parliament since the original corporation had been set up by Parliament, an expeditious method for doing this being set out under section 19 of the Charities Act) under which the income of the charity was to be used after 1973 "for promoting the welfare of young persons who are exposed to moral danger, or are prevented by reason of mental or bodily disease or infirmity or other incapacity, or any other circumstances, from providing proper accommodation, maintenance or training for themselves or their children," any excess income to be used in preventing crime and delinquency among youth or for research into the causes of delinquency.

A second example of needed modernization of charitable purposes is given by Lord Craven's Charity which by will in 1647 established a fund for maintenance of certain scholars with the residue of the gift to be paid ". . . towards the redemption of English christian captive prisoners in Algiers or other places under the dominion of the Turks." Though no income was spent on captives after 1886, and though court orders had widened the scope of educational purposes of the charity during the nineteenth century, a substantial amount of the corpus was still contained in a separate endowment entitled "Lord Craven's Charity for Christian Captives" when the matter came up for reconsideration by the commissioners in 1968. Under amended terms of the fund, income from this fund is currently to be used "for the relief of persons of British nationality and of the Christian faith who are or have been prisoners of war in any of the countries bordering on the Mediterranean Sea and are in distress or who, not being or having been prisoners of war, have otherwise suffered severe distress in any of those countries." The commission, in its 1971 annual report, stated that this application "seemed to be as close as one could get to the original intention of the founder in modern conditions. . . ."[11]

In these and similar cases, the Charity Commission is a far cheaper and more expeditious means of applying *cy pres* than are the courts. The commission sees its powers as being limited by the general judicial doctrine of *cy pres* and, as is clear from the above examples, is quite timid in going beyond or amending the original purpose of established charities. Under section 13 of the 1960 act, the *cy pres* power of both the courts and the commission was extended to situations "where the original purposes, in whole or in part, have, since they were laid down, — (i) been adequately provided for by other means; or (ii) ceased, as being useless or harmful to the community or for other reasons, to be in law charitable, or (iii) ceased in any other way to provide a suitable and effective method of using the property available by virtue of the gift, regard being had to the spirit of the gift." Critics of the commission have often focused on section 13 of the act and cited the commission for being too conservative with respect to the scope of new activities afforded outmoded charities. The commission's interpretation is that "the paramount principle that the donor's intention must be followed as closely as possible has been preserved, but his intention is now interpreted in the light of modern conditions and having regard to the spirit of his gift." A common complaint by charity trustees of, for example, having a hospital charity in an area where there are sufficient hospital facilities is that broader community welfare objects should be allowed to such a charity. The commission will often strain to provide interstitial medical aid to the poor for the charity involved and will clearly not allow the charity to enter a "quite different field of charitable activity." This problem as to statutory restrictions on or non-exercise of discretion by the commission under present law is likely to be a prime focus of the Goodman Commission in its current examination of the Charity Commission and British charity.

Aid to Charities—Investment Policies

As mentioned earlier, the Trustee Investments Act of 1961 was established to modernize investment policy for all trusts, whether charitable or private. Prior to that act, trustees were authorized to invest only in government stocks and first-class securities with fixed income at a fixed redemption value, subject to express powers given in the trust instrument. WIth many charitable trust instruments not providing for broad investment powers, the real value of resources of many charities had decreased considerably by the twentieth century through the inability of the trust to provide any inflation hedge through investments in equity securities.

As part of its general function to disseminate information, the Charity Commission in its annual report for 1960 printed the full text of the 1961 Trustee Investments Act, along with a detailed explanation of the rights and duties of trustees under the act. The act generally allowed charities to divide their assets into two portions, one to be invested in a somewhat standard list of fixed-income securities and the other to be invested in a wide range of industrial and commercial ordinary shares. With greater latitude given the trustees, the 1961 Investments Act imposed obligations of seeking investment counsel and specifically required investment counsel with respect to certain trustee actions.

While the 1961 Investments Act was sufficient for large charities, many small charities simply did not have a large enough fund to justify investment counsel and to permit diversification. Under section 22 of the 1960 Charities Act the Charity Commission was authorized to (concurrent with the court) establish common investment funds. The first fund established was the

National Association of Almshouses Common Investment Fund, set up by a scheme of the commission in May 1962. Beginning in January 1963, another fund, Charities Official Investment Fund, opened with 6,000,000 Pounds Sterling in assets contributed by 5,344 charities. As of January 1974, the fund's assets had grown to nearly 48,000,000 Pounds Sterling. Only registered charities were allowed to participate in this fund through assets held for them by the Official Custodian. As previously pointed out, membeship in the Charities Official Investment Fund carries with it the advantage of receiving gross dividends on a current basis and without having to reclaim tax from the Inland Revenue.

A continuing problem exists in that many parochial charities continue to hold 2.5 percent or 3.5 percent government consols due in 1999. Whenever the commission becomes aware of these situations, on application of charity trustees for advice or for an order, it explains to the charity the benefits of placing funds in the Charities Official Investment Fund or, where the charity is of sufficient size, making use of the 1961 Investments Act.

General Aid, Assistance, and Admonition of Charity

The "moral suasion" approach of the Charity Commission is evident in the aforementioned examples of commission actions. Through its annual reports, the commission informs Parliament and its charitable trust constituency of its activities, and informs trustees as to new legislation or important new cases that may be relevant to charitable activity generally.

The Charity Commission, simply by being established and known to the public, has become a focus for actions affecting charities. A few examples may help to illustrate this.

Under the Finance Bill, 1966, there was introduced a Selective Employment Tax from which charities were not excepted but were instead allowed to receive reimbursement from the Government for payments made by them. The Selective Employment Payments Act, 1966, specifically provided for refunds to charities that were either registered under section 4 of the 1960 Charities Act or were certified as charities by the Charity Commissioners or the Secretary of State for Education and Science.

In areas of common concern to Inland Revenue and the Charity Commission, joint meetings are often held with charitable representatives on what are felt to be important problems. Thus, in its 1963 annual report, the commission reported that a letter had been set to charities operating overseas stressing the importance of adhering to the requirements of both charitable trust and tax law. The commission emphasized that if a public appeal is made for a specific purpose, such as relief of distress in an earthquake abroad, unless the appeal clearly states that unused funds will be used for another purpose, such funds cannot be used for any purpose other than that specified without application to the commission. It was also stressed that the "benefit of community" test applied only to benefits related to the people of the United Kingdom; a different standard was to be applied in using charitable funds in Britain or the Commonwealth as opposed to non-Commonwealth countries. In this overseas charity area and in the political activity area, the commissioners work closely with Inland Revenue in communicating to trustees the dangers of loss of tax exemption and possible surcharge for violation of trust obligations.

In exercising its moral suasion and low-key advisory approach to charities in the international area, the commission is clearly in favor of established registered charities providing overseas disaster aid rather than new charities being set up for each crisis. Thus the commission supports the Disasters Emergency Committee set up in 1964 by five major British charities operating in the overseas area for coordinating disaster relief.

The commission receives a number of complaints each year from members of the general public that fund-raising costs of charities are too high or that charities spend too much on overhead. In its 1970 annual report, the commission pointed out that there was no possibility of setting a firm rule about the percentage of a charity's income which could reasonably be spent on administration, since these costs depended on the type of charity. The commission does follow up on complaints by checking the facts involved and, where warranted, discussing any problems with the charity trustees.

Summary

Other American observers of the operations of the Charity Commission often express surprise at the relatively large number of commission staff who deal with general charitable problems. Yet the large number of ancient charitable trusts in great need of trust-instrument updating could supply sufficient work to keep a staff occupied full-time for many years to come. At this point, the commission does not actively seek out these charities, but waits for the trustees to come to them. Even this process generates a considerable backload of cases.

Some short-circuiting of case-by-case analysis is provided by general publicity efforts aimed at educating charity trustees as to uses of their funds which can be made without application to the commission. Thus, in 1965, the commission, recognizing that the National Health Service had preempted much of the health services field, listed objects for charities that would be considered relief of the sick and would be supplementary to existing national health services.

The commission has clearly not exercised to the fullest its powers to force trustees to modernize; in the Christmas dole and low-income investment areas, for example, it has exhorted but not forced trustees to act. To some extent, this cautious use of powers stems from the commission's attitude of being a "friend of the trustee" and from its attempt to allay the fears of trustees that the commission was a super-regulator. From another point of view, the commission is severely restricted by its budget from becoming an initiating body. From occasional conferences with Inland Revenue on common problems to more frequent contacts with voluntary bodies like the National Association of Almshouses or the National Council for Social Services, the commission with its present staffing, budget, and philosophy, will continue to be largely an instrument of persuasion rather than one of control.

II

TAX TREATMENT OF CHARITIES AND THEIR DONORS

General Tax Principles

In one sense, the British system for charities established by the 1960 Charities Act is much simpler than its U.S. counterpart. Once a charity is registered with the Charity Commission, it is "conclusively presumed to be a charity" until it is removed from the register. Under the Rating Act, 1967, such an entity is automatically exempt from 50 percent of property taxes otherwise assessable against land occupied by it and used for charitable puroses. The local authority is given the option of relieving the charity of the remaining tax, and this is often done where the charity is clearly of benefit to the locality, such as in the case of almshouses. The Selective Employment Tax reimbursement of charities has already been mentioned. And where a charity is registered as such with the commission, Inland Revenue cannot contest the basic charitable nature of the organization.

That registration with the commission confirms charitable status for all purposes does not mean that local tax authorities, with respect to property tax, or Inland Revenue, with respect to income tax, may not deny partially or totally the tax exemption. Thus, for example, many local authorities are taking the position that the thrift shops run by charities are not entitled to the property tax exemption because the premises are not being used for charitable purposes but for "feeder" purposes. Although Inland Revenue may not take the position that a registered charity is not a charity for tax purposes (Inland Revenue or local authorities may bring an action for deregistration of a charity), it can deny in whole or in part the tax exemption for a charity's income if that income is not used for charitable purposes.

Taxation of Charities

Exempt and Unrelated Income

The exemption of charities from income tax and the principle of taxation of donors to charities date back to British laws of 1799 and 1803. Currently, section 360 of the Income and Corporations Taxes Act, 1970, provides for a general exemption for certain categories of income realized by charities, which are much like the kinds of income exempt from tax in the United States: rents from real estate, "so far as the same are applied to charitable purposes only"; interest, dividends, annuities and like income, subject to the same exception; and, capital gains. Section 360(1)(e) of I.C.T.A. 1970 also states the "unrelated business income" rule that profits of any trade owned by a charity are exempt only if the trade is exercised in the course of the actual implementation of the charity's primary purpose(s) or if the work in connection with the trade is carried out primarily by beneficiaries of the charity.

Taking unrelated business income first, the British are quite generous in the interpretation of section 360(1)(e). For example, substantial British estates may be given to the Crown which comprise not only a house of some historical interest but substantial farmlands and income-earning assets. Generally, preservation of the estate as a whole is taken to justify the exemption of income earned from running the estate if it is earned by the charity trustees and devoted to upkeep of the property. An example: Oxfam runs a large number of thrift shops in almost every community in Britain. To the extent that the goods sold are received by Oxfam as contributions, Inland Revenue accepts the position that no "trade" is carried on, in that the ordinary business only sells property that has been purchased by it. The tax authorities at Inland Revenue indicate that because of this narrow interpretation of "unrelated" business income, there has been very little assertion of ordinary income tax against charities on the ground of unrelated trade.

The "covenants" system will be described more fully below in connection with the treatment of donors contributing property to charities. In this examination of unrelated trade questions affecting charities, it is only necessary to point out that income transferred to charity by a written instrument of commitment that satisfies covenant requirements will be allowed as a deduction against trading income of a corporation or proprietorship. Oxfam has in recent years set up, in addition to its thrift shops, other shops where products purchased from artisans overseas are sold to the public, the proceeds to be used for overseas relief. These shops are set up in separate corporate form and are subject to regular tax on their income. However, each of these taxable entities covenants 100 percent of its net income, before taxes, to the charity and is allowed a deduction for the full amount. It is not surprising, in view of the unchallenged use of this system, that unrelated trade income is rarely an issue in audit of British charities.

What is the attitude of Inland Revenue to this clear evasion of the unrelated business income provisions of the Tax Act? While admitting that the purpose of the tax provisions is to prevent unfair competition with taxable businesses, the general position of all levels of personnel in Inland Revenue, from inspectors to the Board of Commissioners itself, appears to be that the 100 percent covenant approach has "not been abused thus far." While technically businesses, the profit-making subsidiaries that enter into these covenants are somehow closely enough related (as in the Oxfam example) to the main purpose of the charity that no public outcry has arisen and no Parliamentary action is considered necessary.

Denial of Income Tax Relief

In conversations with the Office of Chief Inspector of Taxes (Charity), whose staff of 180 is responsible for all charity operations in Britain, I was told that there were some 250,000 index cards in Inland Revenue covering British charities. Inland Revenue's file covers more charities than that of the Charity Commission, for two reasons. First, numerous ecclesiastical and educational charities are exempted from registration with the Charity Commission but appear on Inland Revenue files. Second, many simple trusts set up for special purposes—for example, a fund established by a group of parents to provide a swimming pool for a state-supported school—are recorded as charities on Inland Revenue records even though they are not required to register with the Charity Commission since they are not permanent endowed charities.

Before examining the present responsibilities of Inland Revenue in the charitable area, it is useful to review its position prior to the 1960 Charities Act. Then, Inland Revenue had total responsibility for determining whether an organization was a charity or not. Like the Charity Commission, Inland Revenue never published any pamphlets or guidelines on charitable status, relying entirely on judicial precedent and reasonable extension of such precedent.

The majority of tax in Britain has been traditionally collected through withholding on wages, a method that is also common to the United States. However, in the U.S. no tax creditable against individual income tax is normally withheld from payments to U.S. residents by U.S. corporations whereas, in Britain, tax has been withheld at an approximate 30 percent rate. Tax is also withheld on most interest payments, on annuity payments of various sorts, and on rental income from property where such property is managed by a rental agent. Prior to 1960, organizations did not become qualified as charities through a process of registration with Inland Revenue.

The first contact that Inland Revenue had with most charities was through their application for reclamation of tax withheld on payments to them. At the time the application form was filed, Inland Revenue requested copies of the basic governing documents of the charity and its accounts, and based on examination of this material and any other necessary information obtained from the charity, decided whether tax withheld should be refunded to the charity.

In the rare instances in which a charity received no income subject to withholding tax, Inland Revenue might never have known the charity existed. No regular reports were, or are under present law, filed; and although charities like all other taxpayers are liable for reporting income, whatever its source, penalties are seldom imposed for failure to report, particularly where an organization believes in good faith that it is entitled to exemption because of its charitable status.

Prior to 1960 Inland Revenue thus had the responsibility for defining a charity and for examining the continuing operations of the charity to assure that it met the requirement of section 360 I.C.T.A. 1970 that income on which exemption was claimed was "applied to charitable purposes only." After 1960 the Charity Commission had definitional responsibility with respect to charities subject to registration. As pointed out above, there may be additional charities not required to register whose status is still defined by Inland Revenue. Section 9 of the Charities Act of 1960 provides that the Charity Commissioner may furnish Inland Revenue and other government departments and local authorities information on names and addresses of institutions treated as charitable entities and that Inland Revenue, other government departments, and local authorities may furnish like information to the Charity Commission. An index card on each charity registered with the Charity Commission is automatically forwarded to Inland Revenue. However, the commission has not pressed Inland Revenue, nor has Inland Revenue volunteered, to provide information from Inland Revenue files on charities not registered with the commission. There is a general feeling, despite the permissive language of the 1960 act, that tax information is confidential. Common action by Inland Revenue and the Charity Commission thus normally occurs in publicized cases. Again, the backlog of registration work at the Charity Commission and limited staff may eventually necessitate a cross-check of Inland Revenue files to identify charities that should register under the 1960 act.

Inland Revenue does become aware of the operations of most charities through the process of application for reclamation of tax. The Chief Inspector's office spot checks charities on which information is available through the approximately 5,000 inspectors who audit local activities. And while accounts may not be required of smaller charities on an annual basis, larger charities, as is the case with the Charity Commission, do submit such accounts each year. Unlike the U.S. system where revocation of exemption may be the only form of sanction in cases where funds have been used by a charity for noncharitable purposes, Inland Revenue simply denies reclamation of tax with respect to that part of the income that has been misused. In any egregious case, the matter might be reported to the Charity Commission and the trustees could be personally liable for a surcharge. It has been noted above that the Charity Commission, in its role as "friend of the trustee," may decide not to report to Inland Revenue a minor deviation from the charitable purpose of the trust if the transgression was not willful and the trustees agree to correct the error. Inland Revenue, on the other hand, sees its role in overseeing the operations of charities as one of protecting the revenue but not of ensuring correct implementation of charitable trusts. As was stated by the

Chief Inspector's representative, if a trust for the benefit of dogs uses funds in a charitable way for the benefit of cats, no question is raised by Inland Revenue and no report is filed with the Charity Commission.

The Private Settlement Trust— The Private Foundation Emerging in Britain

The Registration Division of the Charity Commission advised the author that approximately 10 percent of the 1,500 or so new charities being registered each year are "private settlement trusts." These trusts are normally general grant-making charities funded with assets of a family or of a business, with family members or officers of the business serving as trustees. The general purpose of these trusts is the establishment of a separate charitable entity to receive assets which then, after one year, will be free of estate duty. The attitude of the Charity Commission towards these trusts is interesting. The commission tends to take a somewhat easier view of qualification of private settlement trusts than it does of trusts that solicit money from the public, noting that with the former type of trusts "the public does not have the same need to be protected."

In conversations with Inland Revenue staff it was noted that the private settlement trust is not "viewed with alarm at this time." It is recognized that private settlement trusts could possibly be used to perpetuate family control of closely held businesses with the advantage of avoidance of estate duty. However, both the Charity Commission, in its role of assuring that income is used for charitable purposes, and Inland Revenue, in reviewing the extent to which private settlement trusts are used, normally require annual accounts from these private grant-making bodies. The general attitude of the commission and Inland Revenue seems to be that the placing of family assets in a charitable trust serves a legitimate purpose of increasing gifts to charity by avoiding individual surtax on asset income and by providing greater flexibility apart from covenant restrictions for satisfying charitable objectives of the donor-trustors. Inland Revenue is clear, however, that if these British private foundations were to be used primarily for the purpose of controlling family business some Parliamentary action would be taken.

From conversations with members of the Tax Bar in Britain, it does not appear that aggressive use of private settlement trusts by clients is encouraged. Most practitioners queried indicated that this approach would "not be playing the game." Another reason cited was the resulting adverse publicity if a particular client's case became the rationale for Parliamentary action.

Effectiveness of Inland Revenue's Surveillance of Charity

As pointed out above, Inland Revenue maintains its contact with large charities through their annual submission of accounts and is made aware of other charities through their applications for reclamation of tax. In addition, some spot checking is done. Overall, however, there is clearly not the kind of surveillance of charities in Britain that is afforded by the annual reporting requirement in the United States.

The Internal Revenue Service would, I suspect, feel somewhat uncomfortable with the partial information received by Inland Revenue. However, Inland Revenue's response to questions in this area is the same as that of the

Charity Commission, which after a short period of scrutinizing accounts, turned its attention to other matters. Both the Charity Commission and Inland Revenue would simply state that "charities are in general well-behaved." Both realize that many of the small parochial charities may, to some degree, misunderstand what is charitable and what their tax and trust obligations are under the 1960 act and the various Finance Acts. However, unlike the U.S. system where the cannon of chapter 42 excise taxes applies to even the smallest private foundation, the British tax and regulatory authorities are rather willing to forgive minor transgressions.

The general question of abuse in the charitable area was raised with practitioners and with charity trustees or advisors to charity trustees. In general, those persons directly involved with charity seem to have the same feeling as the regulatory and tax bodies—that little abuse of charitable trusts exists.

It is only in the context of this generally held belief, that a curious institutional umbrella protecting charities from scrutiny can be understood. This protection is provided by the previously discussed Office of the Official Custodian in the Charity Commission. He holds the assets of many small charities, and through him, 100 percent of the assets of registered charities may be invested in the Charities Official Investment Fund. By administrative arrangement between the Official Custodian and Inland Revenue, tax withheld from payments to the Custodian or the Charities Official Investment Fund is remitted directly to the Custodian or the fund, and payments are made to the registered charities in the gross amount of dividend plus tax reclaimed. While Inland Revenue, the Custodian, and the fund balance out the relative amounts owed each other at the end of each government fiscal year, no listing of those charities that have been paid is made by the Official Custodian on the ground that this would destroy the administrative simplicity which is the basis of the whole system. The effect of the system is that charities whose assets are held by the Custodian may not come to the attention of Inland Revenue, except through spot-checks, since they may never have to approach Inland Revenue for the reclamation of tax. The author looks with awe on this system which is built largely on faith in the general integrity of charity trustees and the charitable trust system.

Tax Treatment of Donors

Estate Duty

In Britain, something like our unlimited charitable deduction for estates is afforded property given to a very narrow range of what are essentially national charities listed in schedule 25 to the Finance Act, 1972. These include the National Gallery, the British Museum and like national institutions, certain museums and art galleries maintained by local authorities or universities in the United Kingdom, and certain libraries. A deduction is given from the principal value of the estate for gifts to other charities, but only up to a limit of 50,000 Pounds Sterling for all charitable gifts from the estate.

Capital Gains Tax

When the 1965 Finance Act was passed, imposing capital gains on transfers of appreciated property, there was no exception made for gifts to charities. Thus, under this act a donor who contributed appreciated property to a charity was liable as transferor for capital gains tax. With the Finance Act of 1972, an exception was passed which allowed avoidance of capital gains on transfers of property to a charity.

Gift Tax

The 1974 Finance Act has established in principle a transfer tax on inter vivos transfers of property. The details of the tax had not been finally determined at the writing of this report. Preliminary indications of the government were that exceptions will be built into the transfer tax something like the exceptions existing for estate duty. Under present law, this may mean an exemption for gift tax for lifetime gifts limited to 50,000 Pounds Sterling.

The General Income Tax Rule– No Deduction for Charitable Gifts

Turning back to income tax treatment of donors to charity, it is easiest to start with the proposition of British tax law stated by a tax solicitor in Britain: "a gift to charity under British law is to be treated like any other gift, a transfer to another person without restrictions and with no benefit other than the emotional benefits which generosity can generate." As somewhat more formally put by an advisory group on charities and taxation analyzing the proposed 1972 revenue changes in Britain, "generally speaking, ordinary donations by an individual to a charity are not allowable as a deduction for tax purposes. This follows from the principle that the tax system does not in general take account of the way in which the taxpayer spends his money."

The rule, following the above basic principles, is quite simple: except for assignments of income under deed of covenant, described below, there is no income tax advantage for an individual or corporate donor in giving income or property to a charity. There is, of course, the advantage that gifts of property to charity given more than one year prior to the date of death are excluded from the estate of the donor, effectively an election between the government and the charity.

To the American tax lawyer accustomed to 30 percent adjusted gross income deductions for capital gain property, 50 percent adjusted gross income deductions for cash, basic deductions for short-term capital gain property, carry-overs, and the rest, the British system is charming in its simplicity. In addition, British charities and donors, while aware of the American charitable contribution deduction example and equivalent charitable contribution deduction principles in many countries in Europe, are not exerting strong pressure for a change to the American system. To some extent, this may simply be the result of 175 years of history. There is also a feeling on the part of donors and their advisors that the U.S. system under which appreciated property contributions generate a deduction against current ordinary income is an unfair gift to the wealthy. Finally, from the point of view of charities, there are advantages in the present covenant system in terms of knowing in advance the flow of income to the charity and in minimizing year-by-year fund raising.

The Deed of Covenant

The deed of covenant is a most pervasive and distinctive aspect of charitable fund raising and charitable giving in Britain. Whether a potential donor is approached by a major cancer prevention society or a children's puppet theatre, the form of solicitation (aside from door-to-door collection through coin boxes) is likely to be a request for a deed of covenant, often in amounts down to 1 Pound Sterling a year.

In its simplest form, a deed of covenant is an agreement signed by the donor which provides for an annual payment (normally on a fixed date) for seven years from the date of the covenant, unless death intervenes, of a fixed amount to a named charity. (It is for this reason that covenants are normally spoken of as "7-year covenants.") The 7-year covenant is the method of avoiding tax that would otherwise be imposed under section 434 of the Income and Corporation Taxes Act (1970) if a disposition is made "for a period which cannot exceed six years." For a charitable covenant to be effective, the annual payments must be "like," payable for a period which may exceed six years, and not terminable without the consent of the charity entitled to payments except where termination is caused by circumstances outside the powers of the donor, such as death. This statement of the covenant principle makes it much broader than it might at first appear: (1) covenants may be drafted for the period of the donor's life; (2) covenants may only apply to annual periods when the donor is liable to income tax on an equivalent amount covenanted (see below); (3) covenants may depend on marital status, holding of a specified office or employment, or the exceeding of a certain income level; (4) to satisfy the "like" payment requirement, the sum must be calculated in the same way each year—for example, a percentage of gross or net income or profits.

The concept of the covenant goes back to 1803 income tax laws which stated that a taxpayer who made annual payments of a certain amount per year was regarded as having his taxable income decreased by such payments, the payments being added for tax purposes to the income of the recipient. The effect of adding these sums to the income of a charity, the charity being taxed at a nil rate, is that the sum transferred becomes non-taxable. While this simple basic principle remained in effect when the so-called supertax was introduced in 1910, the changes in revenue laws in 1946 applied the exemption from tax only to basic tax and not to surtax.

To illustrate, assume a donor has entered into a covenant with respect to 100 Pounds Sterling per year payable to a named charity. The basic tax is 30 percent, but because of the income level of the donor, he pays a surtax of 40 percent, thus being liable to a tax of 70 percent on his general income received. If the covenant is a net-deed type (under which a stated sum is paid each year), the gift to the charity will be from after-tax income, that is, from the 30 percent of gross income left after paying tax. The charity, after receiving necessary assurances that basic tax has been paid on the income paid over to it by the donor, may reclaim the basic tax of 30 percent from Inland Revenue. The effect of this is that the charity will receive, in addition to the 100 Pounds Sterling from the donor, 42.86 Pounds Sterling from Inland Revenue representing the 30 percent basic tax.

It was stated by representatives of British charity that the net deed of covenant system is very much like the American charitable contributions system. The British donor is able to contribute 143 Pounds Sterling by a net gift of 100 Pounds Sterling because of the tax recoverable from the government. The U.S. donor is able to give a greater amount to the charity because, for the purposes of a tax return filed after the year of gift, he will receive an income tax deduction benefit which will allow him to effectively increase his charitable contribution. This analysis, while it has a surface appeal, understates the tax advantages to the donor in the U.S. system where the deduction allowed is against the highest marginal income tax rate and deductions may be allowed for the full fair market value of property contributed subject to applicable adjusted gross income limits.

Certain traps exist in the 7-year covenant system, for both donors and charities. The donor is under a contractual commitment to deliver to the charity income on which at least the basic tax has been paid. If, because of deductions or some other factor in the tax picture of the donor, he does not pay tax of at least the basic rate, he must pay over to Inland Revenue tax at the basic rate at least sufficient to cover the income covenanted to the charity. Essentially then, there may be a manufacture of taxable income to a donor by use of the covenant. From the point of view of the charity, it is normally desirable to obtain a so-called "gross" covenant—the payment to the charity of a sum out of gross income, or income prior to payment of basic rate tax. The donor pays the sum, less basic rate tax, to the charity and the charity then adds to the amount donated the basic rate tax reclaimed from the government. If a gross deed is not used, there can be a tremedous disadvantage to charities when the basic tax rate is changed. This, in fact, was the case when the basic tax rate went from 38.75 percent to 30 percent. On 100 Pounds Sterling net deed at the 38.75 percent rate, the charity was able to recover just over 63 Pounds Sterling in tax. At the 30 percent rate, tax recoverable on 100 Pounds Sterling net would be approximately 43 Pounds Sterling. Of course, when the basic rate goes up, as has been the case recently when the rate moved from 30 percent to 33 percent, charities gain instead of lose.

The curious result of a tax decrease working to the detriment of charities was recognized by Parliament, and transitional relief for charities in the form of a direct claim against the government for part of the tax reclamation loss was provided for in the Finance Act, 1973.

The covenant may not only be used by individuals but may be used by corporations, and under 1965 regulations of Inland Revenue, covenanted payments are allowed as a deduction from a corporation's income for purposes of computing corporation tax. The corporation must withhold tax from payments to the charities as it would have to in the case of individuals and the charity reclaims such tax from Inland Revenue in the same manner. As outlined above, in discussion of unrelated trading income of charities, Inland Revenue has, so far, allowed situations where business corporations controlled by charities or by "friends" of the charities are allowed to covenant 100 percent of their net income before taxes over to the charity, allowing the charity to do indirectly what it could not do directly without tax. As also stated above, any large-scale abuse of this privilege would probably be corrected by Inland Revenue or Parliament.

To summarize the covenant system, the advantage to the donor is that he may choose his charity and direct taxpayer funds to the extent of the basic tax to supplement his gift. From the point of view of the charity, the covenant procedure allows a certain amount of budgeting since legally committed pledges are assured. One of the basic problems for a charity's administering its covenants directly is cash flow: it must submit evidence of the covenant to Inland Revenue, and Inland Revenue may, because of the necessity of assuring that donors have paid basic tax, hold up payment of tax to the charity until the individual situation of the donor has been checked. In this covenant area and with respect to reclamation of tax on dividends, interest, and so forth, earned directly by the charity, tax reclamation from Inland Revenue may take six months to two years, This time factor underlines the usefulness of the immediate reclamation procedure of the Official Custodian of the Charity Commission and of the trustees of the Charities Official Investment Fund. It has also created a need in the 7-year covenant area, which is part of the reason for establishment of the Charities Aid Fund discussed next.

III

THE CHARITIES AID FUND—A UNIQUE INSTITUTIONAL APPROACH TO PROBLEMS OF CHARITIES AND DONORS

The Charities Aid Fund is a child of the National Council of Social Service, and its origins are as unique as the functions it performs and the new role it recently assumed.

The National Council of Social Service, a conglomerate of national voluntary organizations, is a registered charity set up in 1919. It is a policy-making body in that it is able to speak for social services organizations throughout the United Kingdom. Partially supported by the British Government, it still receives a substantial amount of aid from member organizations and from the general public.

As an administrative body, the National Council of Social Service does not have the same appeal in raising funds from the public that is enjoyed by organizations such as those for the blind, the RSPCA, or the Royal National Lifeboat Institution. Recognizing this, the Charites Aid Fund (CAF) was established in 1924 to perform what was seen as necessary services for charities and to raise funds for the council. In 1974 the Charities Aid Fund was reestablished as the Charities Aid Foundation independent of the National Council. The foundation continues the functions of its predecessor, the Charities Aid Fund, in addition to undertaking new and expanded functions.

The Charities Aid Fund has performed four major functions (each of which should be understood as a part of the CAF's purposes as a registered charity for all purposes).

A major service provided by CAF is its availability as an intermediary between corporate and individual covenanting donors and the charities which the donors wish to benefit. In our description of the normal 7-year covenant, it was pointed out that the deed of covenant was accomplished by a formal instrument in favor of a named charity. The use of CAF by a donor avoids this restriction on donors. By making a covenant for the benefit of the Charities Aid Fund, a donor is able to establish a charitable bank account on which he may draw vouchers. Upon direction of the donor, funds are sent by CAF to the designated charity with CAF recommending that the charity send a receipt directly to the donor.

There are numerous advantages in using CAF as the charity named in a covenant, aside from the flexibility it affords the donor in making contributions. Under British law, only a charity established in the United Kingdom may reclaim basic tax. A direct covenant by a U.K. resident to a U.S. charity would give the U.S. charity no benefit from the basic rate tax paid by the U.K. donor. However, if the same gift is made through CAFand the U.S. charity's purposes are recognized as charitable under British judicial concepts, CAF is able to reclaim tax and the gross amount can be paid over to the U.S. charity. (This advantage of CAF is more than academic since this type of drawing on a CAF account is often used by U.K. donors.) Another advantage is that anonymous gifts that include reclaimed tax may be directed through CAF. This could not be the case where a specific charity was named in a covenant. As an example of the type of gift which might be involved, a corporation sensitive to shareholder criticism would, if it so desired, be able to make gifts to sectarian bodies on an anonymous basis out of its CAF funds.

In the donor service area, substantial administrative advantages accrue in use of CAF. Through good relations with Inland Revenue, CAF recovers tax on a near-current basis, making gross amounts available for donor distributions from their accounts. At the end of each year the CAF lists distributions to Inland Revenue and in some cases there may be questions. To cite one example, a "Christian Sailing League," ostensibly formed to instruct youth in the use of sailboats, turned out to be a rather elaborately financed yacht for private use. The tax reclaimed was replaced by the users of the yacht.

CAF has served as a major champion for donors and charities. Thus, with respect to the Finance Act of 1973, CAF conducted a campaign, including distribution of over 40,000 leaflets, working toward provision of the transitional tax relief for charities to compensate them for loss of income due to reduced basic rates in the personal income tax area. Another provision of the 1973 Finance Act was that annual submission of tax certificates for covenanted sums not exceeding 15 Pounds Sterling a year would no longer be required. This has been of great benefit to donors, charities, and the Inland Revenue in that it avoids the burden of paperwork on perhaps 90 percent of all covenants in the U.K.

In the past the services of CAF were available only to donors who agreed to covenant a certain percentage (normally the greater of 3 percent of the annual covenanted sum or 1 Pound Sterling) to the National Council of Social Service. This intimate connection and trustee control was abolished on the transition of CAF into the Charities Aid Foundation. Some funds will probably still flow to the National Council from general earnings of CAF. Since funds are continually coming to CAF from covenanting donors and since these funds are only called upon from time to time, approximately half of covenanted sums are on hand at any given time and CAF is able to invest these in money market instruments, earning enough for provision of its services with some surplus left over for expansion of operations or, under the old organization, distribution to the National Council. With this surplus available; the 3 percent approach is likely to continue in the future but the monies raised from this will probably be directed to the Social Service Council which is responsible for directing gifts to CAF.

A second major service performed by CAF is the collection of covenant income for the benefit of specific charities. CAF is set up on a well-automated system which makes it easier for CAF to remind donors of their covenants and to administer collection of income. Since there is no "float" in this area as there is in the direct donor covenants to CAF, there is a flat charge of ½ Pound Sterling per account collected.

A third major area in which CAF has carried out functions which one might have expected to be lodged in the Charity Commission is the collection and publication of statistics on British charities. The most notable publication is the "Directory of Grant-Making Trusts" which is relied on by both donors and those seeking contributions for charitable purposes in particular areas. Now computerized, the directory is kept current on a regular basis, and CAF hopes to add reports giving better statistical information on donations to British charity than now exist.

A fourth service provided by CAF is the acceptance of so-called "deposit accounts" for donors. A donor may be committed to donation of a capital amount to charity but may not be in a position to irrevocably commit himself to the particular donee. A capital sum can be placed with the Charities Aid Fund where normally it will be held on investment for a 12-month period (the period during which, if the donor dies, the property would be included in his estate and the assets chargeable with estate duty), after which it is available for distribution to charity at the direction of the donor. It is the creation of a greater ability for donors to give capital amounts that generally represents the expansion of purposes under the newly formed Charities Aid Foundation. The new foundation will continue to provide services already provided by CAF to donors and charities. However, in addition to these services, the foundation will accept contributions of capital amounts which will be used to fund endowments for the benefit of a particular charity or for such charities as shall be named from time to time by the donors or their designates and, failing direction, to charities designated by trustees of the Charities Aid Foundation itself. In essence, the Charities Aid Foundation will provide the services in the United Kingdom that a typical community foundation would provide for a local area in the United States.

The addition of new directions in establishment of the Charities Aid Foundation is described in the 1973 report of the Charities Aid Fund as follows: "Such facilities would be more attractive without the legal costs of establishment and the administrative costs of operation, and the diversification and lack of expertise so often characterizing the small charitable settlement." This statement underscores a philosophy which does not become evident in a mere description of CAF's operations. In the past, CAF has been a major innovator in educating donors as to broader use of the 7-year covenant. CAF's chief executive, J. D. Livingston Booth, has been active in explaining broad use of the covenant and his work is the basis for much of the background description of the covenant contained in the income tax section above. A keynote in CAF's aid to donors and charity has been "activity." CAF does not merely serve as a passive intermediary; it offers to donors under its present program covenants that meet their particular needs, amount-of-income covenants for persons whose incomes are subject to fluctuation, and various other alternatives for maximum use of the covenant principle. It is likely that this same active role will be continued by the new foundation, the objective always being to channel the maximum aid to charity with the minimum of cost.

IV

BRITISH ATTITUDES TOWARD THE CHARITABLE SYSTEM

From the point of view of the regulators, it seems universally assumed that there are few flagrant abuses in the administration of charities by charitable trustees. Questions could be raised about this assumption by the Charity Commission and Inland Revenue in view of the sampling method of inspection and limited scrutiny of operations of British charities. It is likely that more regular inspection of accounts will take place in the future as the registration process in the Charity Commission slows down and staff become available for accounts scrutiny in Liverpool. The assumption of the Charity Commission at this time is that such scrutiny will reveal mistakes due to ignorance of parochial trustees but that, on the whole, trustees will be found to be conscientiously attempting to discharge their trust duties. Inland Revenue is "keeping its eye" on the private settlement trust as a possible development of private foundation abuse but will probably continue its basic assumption that all is well.

The fact that the regulators believe there is little fraud or "tax fiddling" in the present system does not imply a similarly favorable judgment on their part that the British charitable system is efficient. Inland Revenue, as pointed out earlier, is not concerned with the efficiency concept. The Charity Commission is concerned and has attempted on an informal basis through local reviews and moral suasion to influence the attitude of trustees without attempting to appear as a super-regulator. One of the effects of the Goodman Commission may be to force the Charity Commission to use more vigorously the powers it has under the 1960 Charities Act to force trustees of outmoded trusts or of inefficient scope to modernize.

From the point of view of existing or future charities, it does not appear to the author that much friction has been generated between pre-1960 charities and the Charity Commission in view of the general hands-off procedural methods of the commission. However, for certain established charities and for new organizations who think they should be charities, an area of publicized antagonism exists with regard to the scope of political activity afforded charitable organizations. It has been clear to many charities operating in the overseas areas that more good could be done by appropriate influence of Parliament to aid underdeveloped areas than could be done by substantial fund-raising or charitable efforts. Many "political" organizations have solved the problem by establishing charitable funds for limited purposes recognized as such by the Charity Commission. The United Nations Association which is not recognized as a charity has an educational trust which is so recognized, a pattern not unknown in the United States. This "political" argument appears to be part of the general argument that a new definition of charity should be attempted. This again is an area which will probably be examined by the Goodman Commission and the author is of the opinion that the advantages of an elastic semi-judicial definition of charity will prevail as it did in Parliament's final drafting of the 1960 act despite recommendations of the Nathan Committee.

As for the general public, there seems an almost universal faith that British charities are doing a good job and that the basic rate income tax exemption they enjoy is not a great burden on the taxpayer. The British, despite the lack of tax incentives, are likely to dig into their pockets for victims of disasters. And the activities of charities like Oxfam, which is highly visible on a local level, are well publicized. The commission receives complaints from the public that fund-raising costs are too high, but investigation by the commission has revealed little abuse in this area. There are some complaints regarding the exemption from property tax for charities, but despite some efforts of local authorities to curtail the exemption, there seems to be no groundswell of public opinion that property tax relief should be done away with.

Thus, in general, charity regulators and the public seem to regard British charity as a useful institution, not overly privileged and respectably serving public needs. If anything, it appears likely that benefits afforded charities may well increase in the near future rather than additional restrictions being imposed on them. One area that charities are very likely to push for will be a reform of value-added tax to exempt charities from collection and reporting. With the generally favorable British attitude toward charities, they may well succeed.

V

THE FRUITS OF BRITISH EXPERIENCE FOR THE UNITED STATES–A UNITED STATES CHARITY COMMISSION?

Proposed Functions of a National Commission on Philanthropy

At the beginning of this paper, we noted the testimony of Alan Pifer which stressed the need for some sort of supervisory center in the United States sympathetic to the needs of charity. It may be useful at this point to repeat the outline of principal functions of such a center as described by Pifer, along with an elaborating set of characteristics and functions set forth by John S. Noland and Thomas A. Troyer and described in the draft of the report, "Federal Oversight of Philanthropy," prepared by Ginsburg, Feldman, and Bress for the Commission on Private Philanthropy and Public Needs.

The functions outlined by Alan Pifer are as follows:

1. Power to determine charitable status.
2. Maintenance of a central register of charities with listings in the register being a guarantee of tax-exempt charitable status.
3. Conduct of audit of charities.
4. Assurance that legal standards applying to charity are enforced.
5. Issuance of advisory opinions with respect to legal consequences of proposed actions by charitable organizations.
6. Gathering of information and periodic publication of such information on activities and assets of charity.
7. Advice to Congress and the executive branch on charitable matters.

The Nolan-Troyer plan calls for a new agency, perhaps called the National Commission on Philanthropy, set up on an S.E.C. model, supervised by commissioners appointed by the President and confirmed by the Senate. It would have the following characteristics and functions:

1. The commission would be responsible for both the ruling and audit functions now performed by the Service; its determination that an organization meets the standards of section 501(c)(3) would be conclusive upon the Service for exemption and deduction purposes. Applicant organizations would have a statutory right of prompt access to the Tax Court for review of adverse determinations. However, the Service would continue to administer the unrelated business income tax for 501(c)(3) organizations;

2. The commission would issue advance rulings on proposed transactions, receive annual information returns, and have several regional offices from which field-level audit personnel would operate;

3. In accordance with its duties to promote philanthropy, the commission would compile and publish data annually on philanthropic organizations and their receipts and activities, maintain a publicly available register of all exempt charities, and advise Congress and the executive branch on charitable matters;

4. The commission would have the duty to enforce substantive standards established by statute for the various classes of 501(c)(3) organizations. These

standards might continue much of the substantive content of the 1969 legislation for private foundations, and might also direct the commission to establish rules for the uniform disclosure to the public of financial information by organizations making public solicitations for funds;

5. Sanctions for enforcing the standards would include civil actions before the U.S. District Courts to invoke broad equity powers of the kind possessed by the state courts enforcing state fiduciary law. In recognition of the states' powers and responsibilities in regard to charity, the statute conferring such powers upon the federal courts would provide for stay of the federal equity action brought by the commission if state officials initiate parallel state court action, with the federal court then authorized only to take action consistent with any final state court action, much as the Treasury Department proposed to the Ways and Means Committee in 1969;

6. The commission should be nonpartisan, objective, fairminded and independent in its operations; and

7. The commission should be manned both at policy and staff levels by well-trained individuals with the necessary educational background and experience to deal competently with the needs and problems of the charitable field.

The basic reasons for transfer of the regulatory functions of the IRS to a National Commission on Philanthropy as articulated by proponents are summarized in the Ginsburg study as follows: (1) The Service's basic mission of tax collection means that a charity is given a low priority; (2) the IRS is not staffed by professionals with broad liberal arts background, which is desirable in dealing with basic questions of definition of charity, and the exempt organization charity area is a dead-end for IRS or post-IRS careers; (3) The IRS cannot be a leader in improved administration of charity; (4) The revenue-collection procedures and rules of the IRS do not meet charity needs, "the supervison of charities requires greater responsiveness and, perhaps, informality in providing advice (general as well as legal) to charitable organizations, such as that provided by the 'British Charities Commission'"; (5) A new federal agency is needed to fulfill functions not performed by the states in supervision of charities.

The Ginsburg study contains an extensive and useful analysis of the congressional background and details of the statutory establishment of the Assistant Commissioner (Employee Plans and Exempt Organizations) under the Employment Retirement Income Security Act of 1974. With the promise of avoidance of procedural delays and the upgrading of personnel under the new Assistant Commissioner, and from analysis of past Internal Revenue Service performance in the exempt organization area, the Ginsburg study concludes that there should be no transfer of IRS functions to a new national commission. The IRS has been able to expand the charitable concept, and, perhaps because the charitable definition function is a small part of a basic nonideological bureaucracy, the expansion has taken place with little adverse public reaction. The conclusion of the Ginsburg study is further buttressed by the logical nexus between tax collection and the making of the exempt status determination establishing the right of the charity to be tax free and the right of the donor for a charitable contribution deduction.

For reasons more fully stated below, I would agree entirely with the conclusions of the Ginsburg study as far as they go. To return to the principal reasons articulated by proponents of a national commission, as summarized above, the IRS in the past may have been slow in acting on charitable status but in general it has appeared to me as a practitioner and I think the public believes that except in rare instances, the IRS tries to be fair within the context of the statutes it is required to administer. I share the concern of the Ginsburg study that the present system, which does a good job and which promises to do a better job under the new Assistant Commissioner, is preferable to the creation of a new bureaucracy for the qualification, audit, and examination of charities whose character can not be determined at this time.

While somewhat anticipating the discussion below, it should be pointed out that the Charity Commission in Britain was not a new organization supplanting the functions of the tax authorities. The Charity Commission under the 1960 act was much more a stronger body continuing the activities of the Charity Commission under the 1853 act. The registration of charities under the 1960 act was aimed at establishing the constituency of the Charity Commission whose interests were to be promoted and served by the commission. The provision of section 4 of the 1960 act creating the presumption that a registered charity was a charity for all purposes, including tax, was not the introduction of a novel concept into British law. In *Commissioners for Special Purposes of the Income Tax v. Pemsel,* [1891] A.C. 531, it was held that the meaning of "charity" applied by Courts of Equity in administering and enforcing trusts applies equally for the purpose of applying income tax legislation. Institution of the 1960 Charities Act by Parliament simply transferred responsibility for designation of an organization as charitable to the Charity Commission. The basic definition of what constitutes a charitable organization was not changed.

Turning back to the Ginsburg study, its negative conclusion with respect to transfer of IRS functions to a new national commission does not answer the articulated arguments of proponents of a national commission as to the inability of the IRS to give positive advice to charity and to fill the vacuum left by failure of the states to supervise charities. While I can believe that the IRS is fair in determination of charitable status and efficient in enforcement of the revenue laws (including the regulatory functions imposed on the IRS by chapter 42 taxes introduced by the Tax Reform Act of 1969), I find it difficult to believe that auditing agents of the IRS, even as reconstituted under the new Assistant Commissioner, are going to take on the function of giving positive advice to charities or of advising them as to their charitable trust responsibilities under state law.

Summarizing the Ginsburg study conclusions, I would agree wholeheartedly that present IRS functions should be retained in the IRS. But I believe there is still room for positive action to assist, rather than control, charities and that the IRS is an inappropriate body for such assistance.

In Search of a Function for a National Commission on Philanthropy—The Charity Commission Example

Those who testified before the Senate Finance Committee in October 1973 in favor of establishing a national commission clearly had in mind something like the British Charity Commission. I would submit that many of the functions of the Charity Commission would be undesirable, unnecessary, or inappropriate functions of a National Commission on Philanthropy in the United States. I would further submit that any adoption of those Charity Commission functions that are considered useful will have to take account of institutional and attitudinal differences between the two countries.

Charity Commission Purposes Considered Undesirable for the United States

Restrictions on real property transfers. As described in this paper, the Charity Commission, both pre-1960 and post-1960, is required to approve most real property transfers by charities. The rationale is simple: the government body knows best. I have little doubt that U.S. charitable trustees would not look with favor on adoption of this part of the British system.

Strict trust in solicitations. Perhaps because of the quasi-judicial attitude which characterizes the Charity Commission and a rather strict trust theory in court decisions, the Charity Commission tends to impose rather strict and narrow trust requirements on British charities. If funds are raised for promotion of the arts in Brighton, such funds may not be used for the same purpose in Bath; if funds are raised for promotion of ballet, they may not be used for orchestral concerts. I am not at all sure that technically the United States law is that different from British law in this charitable trust area. I am sure as a practitioner and observer of charitable entities that if the trustees of a section 501(c)(3) nonprofit corporation decided to change their purposes to the extent given in the two examples, they would make proper application to the tax authorities and would probably never think of going to the courts or worrying about restrictions imposed by the Attorney General. This is not to say that some aid in the *cy pres* or charitable deviation of purpose area may not be needed by U.S. charities. I do submit that the extremely strict trust concept of the British system would be an undesirable attitude to import into the U.S.

Functions of the Charity Commission Considered Unnecessary for the U.S.

While I cannot speak with authority on East Coast practice, I believe we have little cause for a U.S. statutory attack on the redemption of rent charges in the charitable area. Without the substantial ancient charity history of Britain and with a more practical view of the scope of charitable trust powers in the United States, a National Commission for Philanthropy would be likely to spend little time on trusts for penitent prostitutes or other outmoded functions, the reform of trust instruments in this area occupying a great many man-years of the charities divisions of the Charity Commission. As outlined in the body of this paper, an extremely useful function of the Charity Commission is performed through its Official Custodian. The vesting of title in the Custodian prevents the need for transfer of title with changes in charity trustees. This could be a useful function in the United States, but my impression is that a substantial majority of charities in the United States operate as nonprofit corporations for which transfer of securities and other property is relatively expeditious. A major useful function of the Official Custodian in Britain, directly and through investment of assets in the Charities Official Investment Fund, is to remit income of charities to them free of withholding tax. Without the withholding concept in the United States, this rationale for the Custodian function does not exist.

Charity Commission Functions Possibly Useful to the U.S.

Power to determine charitable status of exempt bodies and duty to submit accounts. As set out above, I would agree with the conclusion that this exemption and audit function should remain with the IRS. The comparison of a proposed system in the U.S. that would give regulatory powers to a national commission with the Charity Commission misunderstands the functions and attitudes of the Charity Commission. The Charity Commission does not see itself as a super-controller; its audits of accounts have been sporadic and its powers to force charitable trustees to come to the commission have not been exercised. The whole approach of the Charity Commission is low-key moral suasion, premised on gaining the confidence of its charitable constituents and on the clearly stated assumption that no substantial abuses exist in the charitable area. While many feel that the U.S. Tax Reform Act of 1969 was an overreaction, it is unlikely that examination and control of the kinds of activities that Congress proscribed in 1969 could be carried out in the informal ways used by the Charity Commission.

Whatever the pros and cons, close surveillance of reports regularly submitted, with penalties for non-reporting, will remain the order of the day in the United States. The Charity Commission is simply not an appropriate model for this kind of activity, nor, it can be added, is Inland Revenue. Again, faith in the system helps to explain the belief that present levels of information received by Inland Revenue in Britain are sufficient to keep it apprised of substantial changes in the area and to regulate activities of charitable bodies. The system in England is one of dual registration, with responsibilities held by the Charity Commission and Inland Revenue. There is no doubt in the minds of both regulators that Inland Revenue has the ultimate responsibility for assuring that tax-exempt income received by charities goes to tax-exempt purposes.

Registration of charities. As part of our argument against transfer of IRS functions to a national commission, the concept of a registration by such a commission which would guarantee tax exemption also is rejected. This is not to say that some sort of registration and publicity function might not be useful in the United States. In Britain the Charity Commission's index of charities is widely available, but the directory of grant-making trusts and other information provided by the Charities Aid Fund is it seems much more useful to prospective donors and to organizations seeking funds from charities than the index file of the Charity Commission. In like manner, in the United States the Council on Foundations, the Foundation Center, and The American Association of Fund-Raising Counsel have developed a good bit of very useful information on charities. Sharing the view of writers of other papers for the Commission on Private Philanthropy and Public Needs, I feel there is a substantial purpose to be served, for which expenditure of public funds is justified, in trying to obtain and organize material available but unassembled in the Internal Revenue Service.

Local review. A substantial hope in the minds of those drafting the 1960 charities act was that British charities would be encouraged to pool their resources and establish worthwhile projects on a local basis. I am not convinced that there is not substantial duplication or mutual help that might be given charities with common or complementary purposes if information existed to make U.S. charities aware of each other and of common goals which might be served by cooperation. This could be a useful ancillary outcome of information gathering and dissemination by a national commission.

General supervision of charitable activities. As opposed to the British system for England and Wales, we must operate in the United States within the context of 50 sovereign states, each theoretically assuring the wise use of charitable assets within its borders. As made clear by the report of the Ohio Attorney General to this Commission, exercise of such state powers is only theoretical in the vast majority of cases. There are exceptions. The California Attorney General examines carefully annual reports submitted to it. Independent of any tax considerations, questions will be raised promptly on details of charitable activities, including requirement for distributions where accumulations seem excessive and requirements that idle funds be kept in interest-bearing accounts. The California Attorney General is also interested in and helpful with respect to problems facing charities in the areas of *cy pres* and deviation, a reasonable course of action for change being approved by his office on a very informal basis or, where it is felt wise, solved by joint application of the charity trustees and the Attorney General to the courts. In states where this sort of activity and interest is not evidenced there may be grounds for assistance by a national commission, which must be tempered so as not to discourage the good job being done by the few states which take these matters seriously while encouraging better systems in other states.

Advice to trustees. The advisory function of the Charity Commission is perhaps one of its most useful functions in aiding charity. By law, such advice insures a trustee against liability unless the advice given is overturned by the court. In the United States, with uneven supervision and assistance of charities at the state level, this sort of advisory function could be a useful one at a national level. Again, where the question is one of state law, the attorney general or appropriate state body might be given a certan period of time to assume jurisdiction. Advice need not be restricted to what are essentially state charitable trust questions. The new restrictions of chapter 42 of the Internal Revenue Code put charitable trustees in jeopardy in many situations where the Internal Revenue Service, because of its general policy against ruling on factual issues, may either not issue a ruling or be extremely slow in responding. It appears to me that an agency outside the Internal Revenue Service which could give advice to trustees binding for trust and tax purposes would be an extremely useful institution.

Publicity and advice to the lawmakers. It has been pointed out that the Charity Commission in its annual reports and by direct correspondence with charitable trustees attempts to keep them current on national legislation applicable to charities. The Charity Commission, as part of government, has been encouraging to groups lobbying with Parliament for legislation favorable to charity but has not itself become involved. The Charities Aid Fund and other independent or semi-independent bodies have been more vigorous in this area. I believe there is much good to be done in establishment of a national commission if one of its functions included information gathering, not just information about charities and their purposes but information useful to charities. (For example, a new charity is established to attack a particular local problem in the mental health area. What state or federal grants are available? With a good deal of leg-work and expense, the answer to this kind of question can be found.) If information could flow from the charities to the national commission, the commission would be a more appropriate vehicle than the IRS for reporting problems of charities to Congress and the executive branch. Finally, if a national commission were well publicized it could, like the British Charity Commission, be a focal point for comments on and complaints about charitable activities.

Solicitation control. The Charity Commission may encourage other groups like the National Council of Social Service in the establishment of guidelines for solicitation. However, the Charity Commission is not itself involved directly in controlling solicitation, this being handled by the Home Office and/or local police authority. If a national commission is to be formed in the United States, I would agree with others (the Ginsburg study, for example) that the solicitation control authority should be housed in a body other than the commission. Such a commission should be an assisting body, not a controlling body.

Recommendations for a National Commission

For reasons discussed above, I would recommend against the transfer from the Internal Revenue Service of exemption definition, audit, and compliance functions with respect to section 501(c)(3) organizations.

I would strongly recommend the establishment by Congress of an organization with a limited life of perhaps three years and funded to carry out the following initial functions:

1. The premise of every student of charitable activities in the United States, whether the author, this Commission, the executive branch or Congress, is that we simply do not have sufficient information about charitable activities to make informed judgments about their operations, problems, abuses, and what actions by government are necessary. Taking as a model the Foreign Investment Study Act of 1974 (P.L. 93-479), there should be established a National Commission on Philanthropy which, with force of law for noncompliance, would be authorized to obtain a complete sample of all section 501(c)(3) active organizations on file with Internal Revenue Service. The act establishing the commission would authorize submission of a questionnaire to these charities, which would seek information on source of donations, use of funds and other statistical information, on problems under local law, in Internal Revenue Service relations or with revenue law compliance, and on areas where the assistance of a permanent national body for aiding charities might be useful.

2. The act establishing the national commission would assure access of the commission to all records of the Internal Revenue Service, subject to appropriate individual disclosure safeguards.

3. The act would authorize a survey of the attorney general or appropriate body of each state, the District of Columbia and the other U.S. controlled areas for the purpose of further studying application of charitable trust supervision and assistance at the local level. In this survey, the reaction of local authorities to a supplementary national system of assistance and advice or a preemptive national system would be explored.

4. As part of the questionnaire requesting information on needs of charities or through independent studies, the national commission would explore the need for (a) a national registry of charities by geographical area, size, charitable functions served, and such other information which charities or potential grant recipients might find useful; (b) a mechanism for encouraging cooperation between and/or amalgamation of assets of charities with common goals; (c) in the area of *cy pres* or deviation from purpose, assistance to charities through national legislation which preempts or complements state law; (d) advice from a national commission, binding for trust and tax purposes, with respect to correct action of charitable trustees within the terms of their trusts and with respect to the freedom of trustee actions from chapter 42 taxes; (e) information which could or should be made available to charities through a national clearing-house.

Finally, the commission's studies should seek to determine the proper constitution of a permanent national commission established for any or all of the above purposes. Should this body be active in promoting legislation for the benefit of charities generally? How will smaller charities assure themselves a voice with respect to their problems?

Within a specified time established by the act setting up the national commission, the commission would report back to Congress with the results of its studies, a statistical picture of charity and charitable objects, and its recommendations as to whether a permanent national body should be established and, if so, its recommendations as to the form and constitution of such national body.

Perhaps, if the above recommendations are implemented in their present or varied form, we may succeed in establishing an effective national body aimed primarily at assisting, rather than controlling and punishing, U.S. charity. On the other hand, a possible conclusion of an exploratory study may be that there is no justification for establishment of a permanent national commission.

Whatever the outcome of recommendations with respect to a National Commission on Philanthropy, there appears to be general agreement that the IRS will continue, perhaps more efficiently and with an eye to the value of charity under the new office of the Assistant Commissioner, the function presently performed by it. Taking this as a given, my last recommendation would be the establishment within the IRS of an Ombudsman whose sole function would be the investigation and prosecution of complaints from charities administered by the Internal Revenue Service.

In outlining areas where I believe a national commission could be useful, I have stressed that such assistance functions do not appear appropriate to the IRS in the context of its tax and regulatory responsibilities. It does appear to me, however, that charities have the right to insist that IRS carry out its functions efficiently and fairly and that it be aware of and investigate instances where those regulated by it feel that standards of efficiency and fairness are not met.

Footnotes

1. Keeton and Sheridan, *The Modern Law of Charities*, second edition (Belfast, 1971), pp. 210-211.

2. Nathan Report, Appendix F.

3. Charity Commission, 1973 Annual Report, ¶10.

4. Ibid., ¶3.

5. Charity Commission, 1966 Annual Report, ¶27-41.

6. Charity Commission, 1970 Annual Report, ¶26.

7. Ibid., ¶67.

8. Charity Commission, 1968 Annual Report, ¶45-64.

9. "Pressure for Shakeup in the Charity Commission," *The Observer* (August 4, 1974), p. 4.

10. Charity Commission, 1970 Annual Report, ¶51.

11. Charity Commission, 1971 Annual Report, ¶65-69.